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LIONS ON THE MOVE II: REALIZING THE POTENTIAL OF AFRICA'S ECONOMIES

SEPTEMBER 2016

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LIONS ON THE MOVE II: REALIZING THE POTENTIAL OF AFRICA'S ECONOMIES

SEPTEMBER 2016

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PREFACE

Has Africa's growth run out of steam? This question is on the minds of many investors, business leaders, and policy makers as they observe the effects of lower resource prices and higher levels of sociopolitical instability on the continent's GDP. Compared with the consistently positive growth trajectory we described in our 2010 report on Africa's economies, *Lions on the move: The progress and potential of African economies*, the picture today is more complex. Growth paths among Africa's economies have diverged.

This more mixed picture seemed to make this a good time for MGI to revisit Africa's growth story. In this report, we look beyond Africa's immediate challenges and assess economic prospects to 2025 and beyond. The findings should be encouraging both for companies looking for business-building opportunities and for governments seeking to accelerate growth and human development. In the years ahead, Africa will benefit from strong fundamentals including a young and growing population, the world's fastest urbanization rate, and accelerating technological change. These will help drive rapid growth in consumer markets and business supply chains and will offer opportunities to build large, profitable industrial and services companies. But much work needs to be done both by companies themselves and by Africa's governments to translate opportunity into tangible economic benefits.

This research was led by Acha Leke, a senior partner based in Johannesburg; Mutsa Chironga, a partner based in Johannesburg; Tenbite Ermias, a partner in Nairobi; Omid Kassiri, a partner based in Nairobi; Susan Lund, an MGI partner based in Washington, DC; and Yassir Zouaoui, a partner based in Casablanca. We are also very grateful to colleagues who closely guided this work, namely Jacques Bughin, a McKinsey senior partner and director of MGI based in Brussels; Armando Cabral, a McKinsey senior partner in Luanda; Georges Desvaux, a senior partner based in Johannesburg; Reinaldo Fiorini, a senior partner in Lagos; Adam Kendall, a partner in Casablanca; James Manyika, a senior partner of McKinsey and director of MGI based in San Francisco; Bill Russo, a senior partner in Nairobi; and Saf Yeboah-Amankwah and Arend Van Wamelen, senior partners based in Johannesburg.

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This report contributes to MGI's mission to help business and policy leaders understand the forces transforming the global economy, identify strategic locations, and prepare for the next wave of growth. As with all MGI research, this work is independent and has not been commissioned or sponsored in any way by any business, government, or other institution. We welcome your comments on the research at MGI@mckinsey.com.

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IN BRIEF

LIONS ON THE MOVE II

Many people are questioning whether Africa's economic advances are running out of steam. Five years ago, growth was accelerating in almost all of the region's diverse economies, but recently their paths have diverged. Some countries have continued to grow fast while others have experienced a marked slowdown as a result of lower resource prices and higher sociopolitical instability. Despite this, the continent's fundamentals remain strong, but African governments and companies will need to work harder to make the most of its potential.

- Africa's real GDP grew at an average of 3.3 percent a year between 2010 and 2015, considerably slower than the 5.4 percent from 2000 to 2010. However, this average disguises stark divergence. Growth slowed sharply among oil exporters and North African countries affected by the 2011 Arab Spring democracy movements. The rest of Africa posted accelerating growth at an average annual rate of 4.4 percent in 2010 to 2015, compared with 4.1 percent in 2000 to 2010. Africa as a whole is projected by the International Monetary Fund to be the world's second-fastest-growing economy to 2020.
- The region has robust long-term economic fundamentals. In an aging world, Africa has the advantage of a young and growing population and will soon have the fastest urbanization rate in the world. By 2034, the region is expected to have a larger workforce than either China or India—and, so far, job creation is outpacing growth in the labor force. Accelerating technological change is unlocking new opportunities for consumers and businesses, and Africa still has abundant resources.
- Spending by consumers and businesses today totals $4 trillion. Household consumption is expected to grow at 3.8 percent a year to 2025 to reach $2.1 trillion. Business spending is expected to grow from $2.6 trillion in 2015 to $3.5 trillion by 2025. Tapping consumer markets will require companies to have a detailed understanding of income, geographic, and category trends. Thriving in business markets will require them to offer products and develop sales forces able to target the relatively fragmented private sector.
- Africa could nearly double its manufacturing output from $500 billion today to $930 billion in 2025, provided countries take decisive action to create an improved environment for manufacturers. Three-quarters of the potential could come from Africa-based companies meeting domestic demand (today, Africa imports one-third of the food, beverages, and similar processed goods it consumes). The other one-quarter could come from more exports. The rewards of accelerated industrialization would include a step change in productivity and the creation of six million to 14 million stable jobs over the next decade.
- Corporate Africa needs to step up its performance to make the most of these opportunities. The continent has 400 companies with revenue of more than $1 billion per year, and these companies are growing faster, and are more profitable in general than their global peers. Yet Africa has only 60 percent of the number of large firms one would expect if it were on a par with peer regions—and their average revenue, at $2 billion a year, is half that of large firms in Brazil, India, Mexico, and Russia, for instance.[1] No Africa-owned company is in the Fortune 500. Companies looking to grow across the continent should develop a strong position in their home market, use that as a base for expanding into markets well beyond their immediate region, adopt a long-term perspective and build the partnerships needed to sustain success over decades, and be ready to integrate what would usually be outsourced. They should look for opportunities in six sectors that MGI finds have "white space"—wholesale and retail, food and agri-processing, health care, financial services, light manufacturing, and construction—with high growth, high profitability, and low consolidation, and invest in building and retaining talent.
- Governments will have to play a stronger role in unleashing renewed dynamism. Six priorities emerge from this research: mobilize more domestic resources, aggressively diversify economies, accelerate infrastructure development, deepen regional integration, create tomorrow's talent, and ensure healthy urbanization. Delivering on these six priorities will require the vision and determination to drive far-reaching reforms in many areas of public life—and capable public administration with the skill and commitment to implement such reforms.

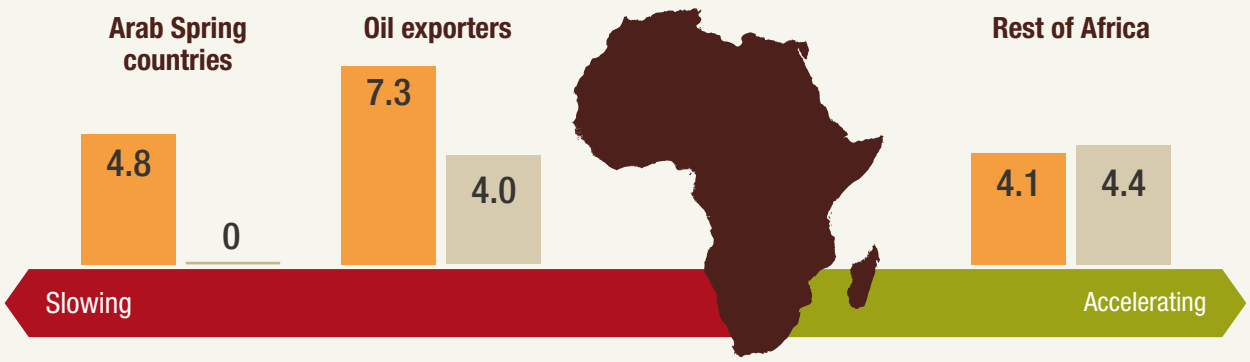
Download the full report at **www.mckinsey.com/mgi**

[1] Excluding South African companies.

LIONS ON THE MOVE
Realizing Africa's potential

Africa's growth path is diverging

Real compound annual growth rate, %



$5.6 trillion

in **African business opportunities** by 2025

$2.1 trillion
Household consumption

$3.5 trillion
of B2B spending[1]

Manufacturing output
can **double** by 2025

Africa needs more large companies to power growth

400 African companies with annual revenue exceeding **$1 billion**

African companies **grow faster** and are **more profitable** than global peers...

0 ...but there are **zero** African companies in the Fortune 500

Government imperatives

Mobilize domestic resources	Aggressively diversify economies	Accelerate infrastructure development	Deepen regional integration	Create tomorrow's talent	Ensure healthy urbanization

Transform public leadership and governance

[1]Business-to-business spending

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EXECUTIVE SUMMARY

In 2010, the McKinsey Global Institute's report on the African economy—*Lions on the move: The progress and potential of African economies*—highlighted a quickening of Africa's economic pulse and a new commercial vibrancy.[1] Real GDP had grown at 4.9 percent a year between 2000 and 2008, more than twice its pace in the 1980s and 1990s, making Africa one of the most rapidly growing regional economies in the world. With growth in 27 of the 30 largest economies accelerating compared with the previous decade, Africa was clearly on the rise. But six years on, growth has slowed significantly. Between 2010 and 2015 Africa's overall GDP growth averaged just 3.3 percent. Is Africa's renaissance losing its vigor?

3.3%
average real GDP growth in Africa, 2010–15

There is no doubt that the region's overall growth performance has been dragged down in recent years by a sharp slowdown in particular economies. The economies of Egypt, Libya, and Tunisia were badly affected by the political turmoil of the Arab Spring, and Africa's oil exporters were left vulnerable to the decline in oil prices. However, the rest of Africa continues to enjoy strong growth; the African story is diverging. Regardless, the fundamentals across the whole continent are strong, and long-term growth projections are good. The region is expected to enjoy the fastest urbanization of any region in the world, and to have a larger workforce than either India or China by 2034. It also has a huge opportunity to leverage internet and mobile technology, and still has abundant resources.

The region is expected to enjoy the fastest urbanization of any region in the world.

Despite recent shocks and challenges, Africa's household consumption and business spending are both growing strongly, offering companies a $5.6 trillion opportunity by 2025. Africa's manufacturing sector today underperforms those of other emerging economies. However, output could expand to nearly $1 trillion in 2025 if Africa's manufacturers were to produce more to meet domestic demand from consumers and businesses, and work with governments to address factors hindering their ability to produce and export goods.

To achieve this potential will require Africa's companies to step up their performance. Africa is home to 700 companies with revenue of more than $500 million per year, including 400 with revenue above $1 billion. However, the region has a relatively small number of large companies. It needs more. The top 100 African companies have been successful by building a strong position in their home market before expanding, adopting a long-term perspective, integrating what they would usually outsource, targeting high-potential sectors with low levels of consolidation, and investing in building and retaining talent.

Governments will need to address productivity and drive growth by focusing on six priorities emerging from this research: mobilize more domestic resources; aggressively diversify economies; accelerate infrastructure development; deepen regional integration; create tomorrow's talent; and ensure healthy urbanization. This agenda will require a step change in the quality of African leadership and governance, and active collaboration between the public and private sectors.

[1] *Lions on the move: The progress and potential of African economies*, McKinsey Global Institute, June 2010.

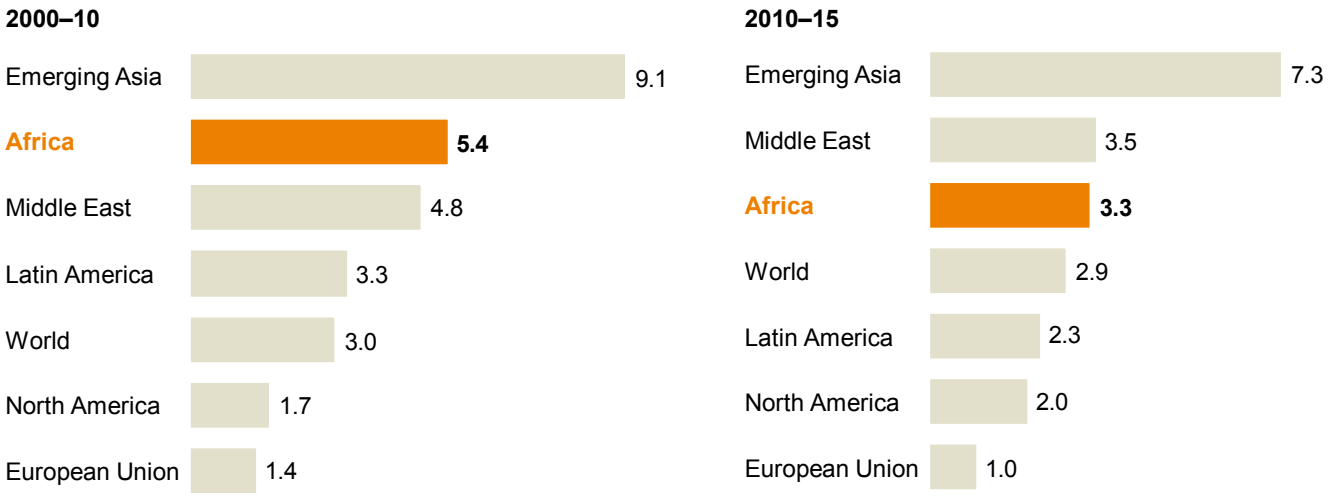
AFRICA'S GROWTH OUTLOOK HAS BECOME MORE NUANCED DUE TO SHOCKS IN PARTS OF THE REGION

Key economic indicators for Africa point to slowing growth—in common with other major emerging markets. Between 2010 and 2015, GDP grew at 3.3 percent a year, sharply slower than the 5.4 percent average annual growth rate between 2000 and 2010 (Exhibit E1).[2] Annual productivity growth also slowed between these two periods, from 2.3 percent in 2000–10 to 0.8 percent in 2010–15. Foreign direct investment (FDI) and other capital flows into Africa have leveled off, a far cry from the period from 2005 to 2010 when such flows had tripled. At the same time, savings have fallen steeply from a peak of 27 percent of GDP in 2005 to 16 percent in 2015. It has become increasingly difficult for African countries to compensate by tapping global debt markets. The continent's average debt-to-GDP ratio rose from 40 percent in 2011 to 50 percent in 2015, still relatively low by global standards. However, sovereign debt yields have risen sharply in many countries. The pan-African average budget deficit in 2015 exceeded 6 percent of GDP.

Exhibit E1

Like other emerging economies, Africa as a whole has experienced a growth slowdown over the past five years

Measured real GDP growth
Compound annual growth rate
%



SOURCE: *World economic outlook: Too slow for too long,* IMF, April 2016; McKinsey Global Institute analysis

However, closer analysis shows that this rather disappointing combination of indicators tells a misleadingly negative story. The overall slowdown in Africa's growth largely reflects economic deterioration in two distinct groups of countries: North African countries caught up in the turmoil that followed the democracy movements collectively known as the Arab Spring, and oil exporters affected by the sharp decline in oil prices. Together these two groups account for nearly three-fifths of Africa's combined GDP (Exhibit E2). As a group, Egypt, Libya, and Tunisia did not grow at all between 2010 and 2015, having grown at an average rate of 4.8 percent over the previous decade.[3] The rate of growth among oil exporters Algeria, Angola, Nigeria, and Sudan fell sharply from 7.3 percent to 4.0 percent between the two periods. Productivity growth also declined in these two groups of economies, from 1.1 percent to 0.3 percent in the Arab Spring countries and from 3.9 percent to 1.4 percent in Africa's oil exporters.

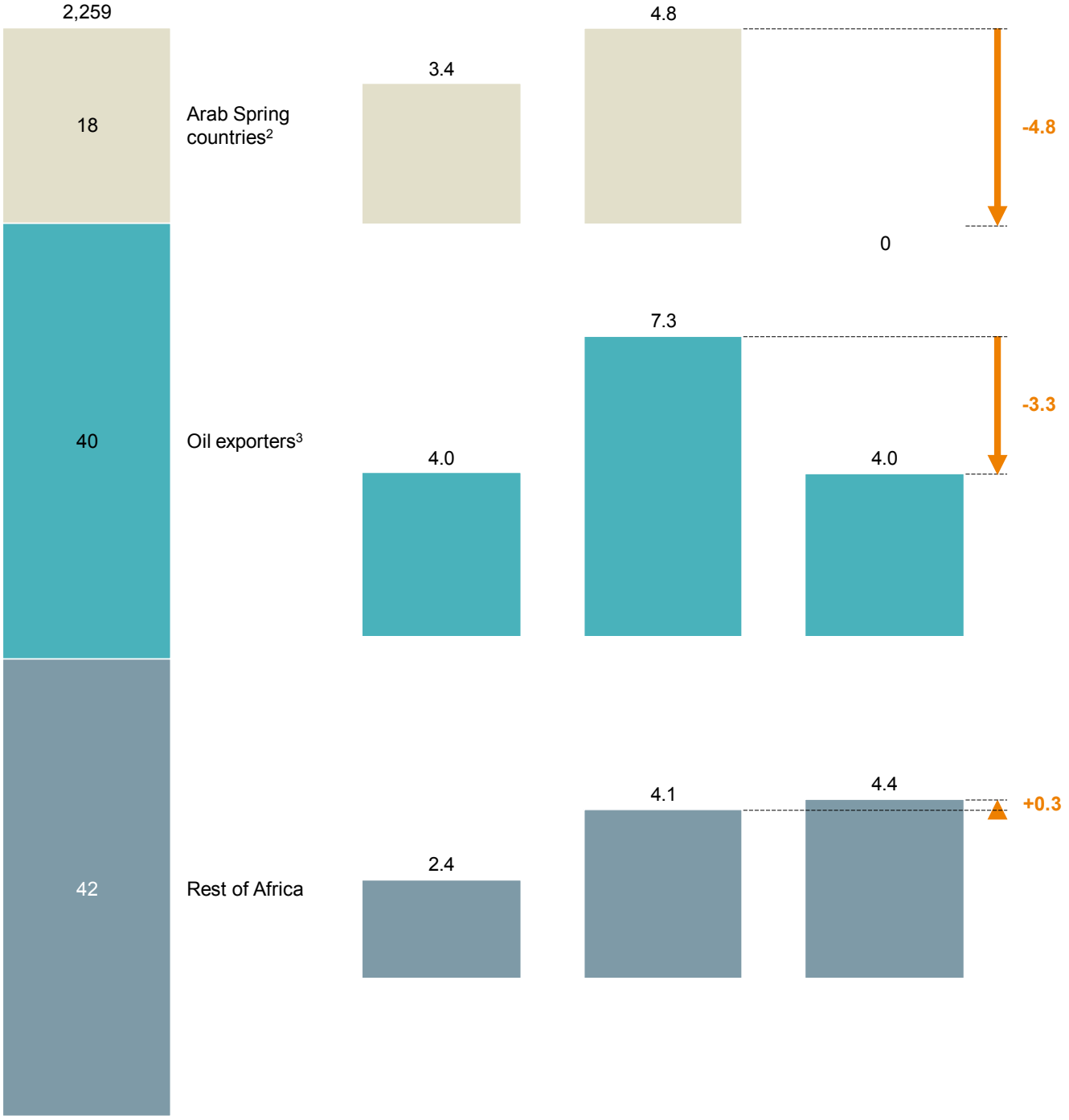
[2] In real prices.

[3] Egypt and Tunisia experienced slower growth of 2.5 percent and 1.5 percent respectively, while Libya's economy contracted.

Exhibit E2

A sharp growth slowdown in Africa's oil exporters and countries involved in the Arab Spring dragged down the region's average GDP growth

	1990–2000	2000–10	2010–15
Total African GDP growth rate %	3.1	5.4	3.3



1 Includes GDP data for 53 African countries, excluding South Sudan.
2 Egypt, Libya, and Tunisia.
3 Algeria, Angola, Chad, Democratic Republic of Congo, Equatorial Guinea, Gabon, Nigeria, and Sudan.
NOTE: Numbers may not sum due to rounding.

SOURCE: *World economic outlook: Too slow for too long,* IMF, April 2016; McKinsey Global Institute analysis

In the rest of the continent, GDP growth accelerated to an average annual rate of 4.4 percent in 2010–15 from 4.1 percent in 2000–10. Productivity grew at a consistent compound annual rate of 1.3 percent over both periods. Since 2010, GDP growth has accelerated in around half of the largest 30 economies and decelerated in the other half. The decelerating economies include the continent's six largest—Nigeria, Egypt, South Africa, Algeria, Morocco, and Angola—while the accelerating countries include Botswana, Cameroon, Côte d'Ivoire, Democratic Republic of Congo, Ethiopia, Gabon, Ghana, Kenya, Madagascar, Namibia, Senegal, Tanzania, and Zimbabwe.

6
largest African economies have grown more slowly since 2010

This variance is a reminder that Africa is a diverse regional economy and that countries on the continent remain vulnerable to economic, social, and political shocks. To better gauge stability at the country level, MGI has developed an African Stability Index that we hope can help businesses and investors understand their portfolio risk and help policy makers understand and address their own countries' vulnerabilities.[4] The index highlights the diverging growth and stability trends that economies in the region have been experiencing since MGI published its first report on Africa's economies in 2010.[5] Three distinct groups emerge from the index (Exhibit E3).

- **Stable growers.** These countries, which accounted for 19 percent of Africa's GDP in 2015, posted average GDP growth of 5.8 percent a year between 2010 and 2015—higher than the 2.9 percent a year global average over this period—and demonstrated relatively high levels of stability. This group includes Botswana, Côte d'Ivoire, Ethiopia, Kenya, Mauritius, Morocco, Rwanda, Senegal, Tanzania, and Uganda. These countries, typically not dependent on resources for growth, are smaller economies that are progressing with economic reform and increasing their competitiveness.

- **Vulnerable growers.** These countries, which accounted for 35 percent of African GDP in 2015, achieved average GDP growth of 5.1 percent a year over the past five years but had relatively low levels of stability. This group includes countries heavily dependent on resources, such as Nigeria, Angola, and Zambia, as well as countries such as the Democratic Republic of Congo, which have clear potential but need to improve their security, governance, or macroeconomic stability.

- **Slow growers.** These countries, which accounted for 46 percent of Africa's GDP in 2015, together grew at 1.3 percent per year between 2010 and 2015—less than the 2.9 percent a year global average over that period—and have had varying degrees of stability. This group includes the countries affected by the Arab Spring—Libya, Egypt, and Tunisia. It also includes South Africa, which is experiencing slow growth and high unemployment in spite of promising opportunities that could spur development.[6]

[4] The stability component of the index measures three factors, each given equal weighting. The first is the country's macroeconomic stability, which reflects its gross debt-to-GDP ratio and its external balances measured by reserves in months of imports. The second is economic diversification, as measured by resources as a share of exports. The third is social and political stability, which includes unemployment levels, the number of incidents of violence, and the Ibrahim Index of African Governance. Each country's stability ranking is then plotted against its recent historical growth, the compound annual GDP growth rate for 2010 to 2015.

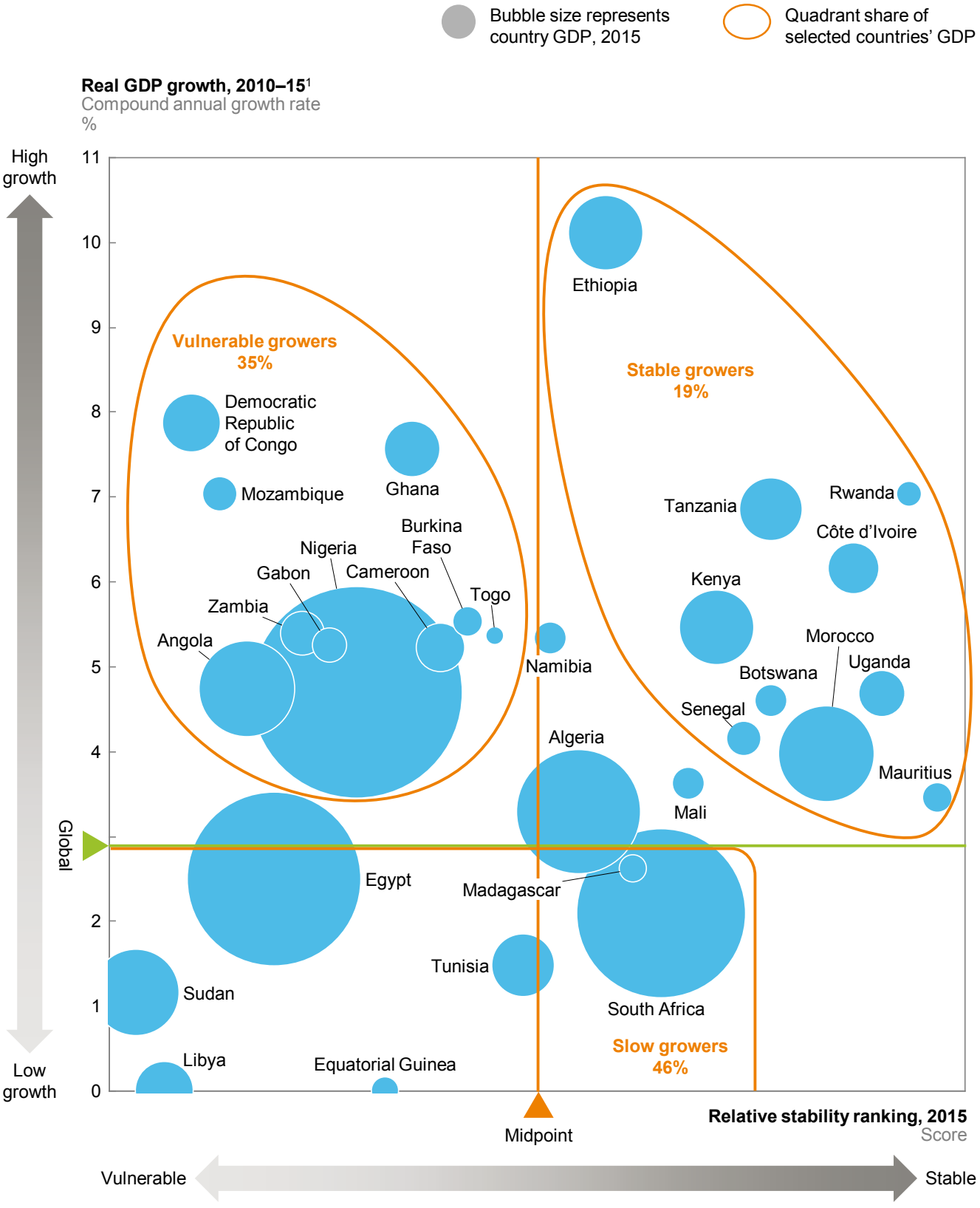
[5] *Lions on the move: The progress and potential of African economies*, McKinsey Global Institute, June 2010.

[6] *South Africa's big five: Bold priorities for inclusive growth*, McKinsey Global Institute, August 2015.

Exhibit E3

Some countries have weathered economic challenges better than others—three divergent groups emerge from MGI's African Stability Index

Comparison of historical GDP growth rates to country stability rankings



1 The index covers 30 economies accounting for 96% of GDP; Equatorial Guinea and Libya are plotted manually because of negative growth rates over this period.

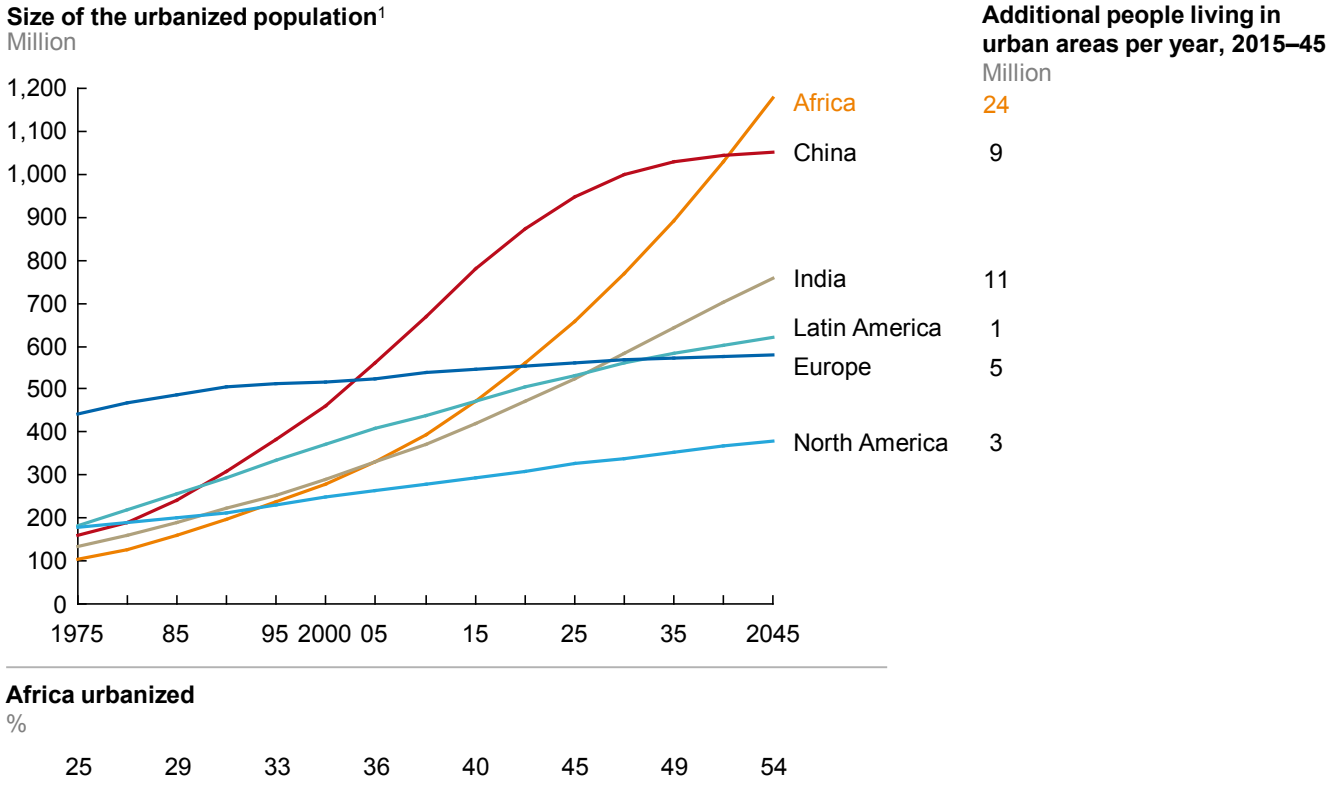
SOURCE: *World economic outlook: Too slow for too long,* IMF, April 2016; McKinsey African Stability Index; McKinsey Global Institute analysis

Despite African economies diverging in their growth paths from 2010 to 2015, the continent's overall outlook remains promising. Africa's collective GDP is still expanding faster than the world average, and it is forecast to accelerate over the next five years to become the world's second-fastest-growing region once again. In the longer term, four factors could have a transformative effect on the continent's economies and their pace of growth.

- **The world's fastest urbanization.** Africa is the world's fastest urbanizing region. Over the next decade, an additional 187 million Africans will live in cities—equivalent to ten cities the size of Cairo, Africa's largest metropolitan area.[7] Between 2015 and 2045, an average of 24 million additional people are projected to live in cities each year, compared with 11 million in India and nine million in China (Exhibit E4). Urbanization has a strong correlation with the rate of real GDP growth, because productivity in cities is more than double that in the countryside: Africa's urban GDP per person was $8,200 in 2015, compared with $3,300 in rural areas.[8] Higher productivity translates into higher incomes, and cities offer better access to infrastructure, education, and new markets, resulting in more rapid growth in consumption by households and businesses. The challenge will be to cope with the stresses of rapid urban expansion, including provision of housing and services.

Exhibit E4

Africa is urbanizing faster than any other region; its cities are expected to gain 24 million people each year until 2045



1 Population living in urban areas. UN forecasts last adjusted in 2014.

SOURCE: World urbanization prospects, June 2014 revision, United Nations population division; McKinsey Global Institute analysis

7 McKinsey Global Institute Cityscope, 2015.

8 MGI estimated this figure by splitting into rural and urban activities sectoral data from the International Labour Organization, *World economic outlook*, IMF, April 2016; United Nations Statistics Division; national statistical offices; and Lars Christian Moller, *Ethiopia's great run: The growth acceleration and how to pace it*, World Bank working paper number 99399, November 2015.

- **A workforce larger than those of either China or India by 2034.** Africa has a young population and a growing labor force—a highly valuable asset in an aging world. The challenge for Africa will be to ensure that its economies continue to create sufficient jobs for the many millions of young people entering the workforce—thus far the signs are positive with the rate at which stable jobs have been created outpacing growth in the workforce—and to help develop their skills. By 2034, the working-age population is expected to be 1.1 billion, larger than that of either China or India. Roughly 60 percent of the world's population lives in countries with fertility rates below replacement rates and, for the first time in human history, demographic change could mean that the planet's population plateaus. In some countries, one-third of the workforce could retire in the period to 2025, with a potentially negative impact on economic growth prospects. However, Africa's demographics are still working in its economic favor: an expanding working-age population is associated with strong rates of GDP growth.

Africa has a young population and a growing labor force—a highly valuable asset in an aging world.

- **Huge potential from accelerating technological change.** The accelerating scope, scale, and economic impact of technology is a major transformative force around the world.[9] Faster penetration of the internet and mobile phones offers Africa a huge opportunity to enhance growth and productivity; Africa's penetration of smartphones is expected to reach 50 percent by 2020, from only 18 percent in 2015.[10] Previous MGI research estimated that the internet could drive 10 percent of Africa's GDP by 2025.[11] This trend is already transforming a number of sectors, including banking, retail, power, health care, and education. Electronic payments are sweeping across the region and changing the business landscape. East Africa is already a global leader in mobile payments. E-commerce in Africa is growing quickly—revenue has doubled in Nigeria each year since 2010. In South Africa, smart metering is taking off and is expected to modernize consumer payments in the power sector, while ambulance services are using mobile application technology to improve response times greatly. The African Leadership University, launched in Mauritius in 2015, is using technology to reduce teaching costs and deliver e-learning, creating a replicable model for expansion across the continent.

- **Continued abundance of resources.** Africa contains 60 percent of the world's unutilized but potentially available cropland, as well as the world's largest reserves of vanadium, diamonds, manganese, phosphate, platinum-group metals, cobalt, aluminum, chromium, and gold. It is responsible for 10 percent of global exports of oil and gas, 9 percent of copper, and 5 percent of iron ore. Even at recent low prices for such commodities, a significant share of African production continues to be cost-competitive, putting the resources sector in a strong position for when demand—and, eventually investment—recover.[12] Capturing these opportunities will be challenging. Governments will need to improve their investment attractiveness in a weaker environment, while companies must review their approach to community engagement so that they have the support of local communities as well as their "license to operate" from regulators.

9 See Richard Dobbs, James Manyika, and Jonathan Woetzel, *No ordinary disruption: The four forces breaking all the trends*, PublicAffairs, 2015.

10 Estimated by MGI using forecasts from *The mobile economy: Sub-Saharan Africa 2015*, GSMA, 2015; UN Population Division.

11 *Lions go digital: The internet's transformative potential in Africa*, McKinsey Global Institute, November 2013.

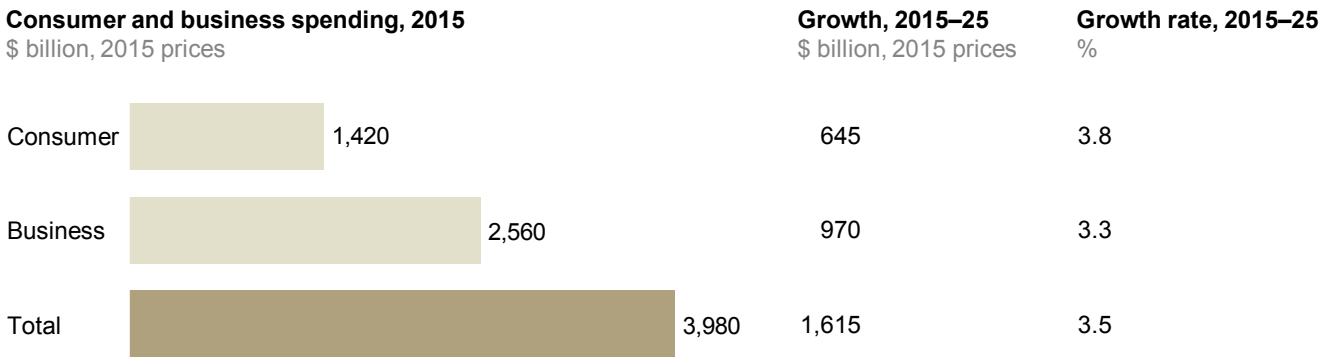
12 When taking into account only the technical costs or equivalent, before royalties and taxes.

THE RISING AFRICAN CONSUMER AND BUSINESS SPENDING OPPORTUNITY IS WORTH $4 TRILLION

There is a $4 trillion opportunity for businesses to tap in the form of rising consumer and business spending. Of this, household consumption accounts for $1.4 trillion, and business spending $2.6 trillion (Exhibit E5).

Exhibit E5

Consumer and business spending in Africa represents a $4 trillion opportunity



SOURCE: Oxford Economics; IHS; McKinsey Global Institute analysis

Nearly
$2.1T
household consumption expected in 2025

Meeting the changing needs of Africa's growing consumer class

Africa's household consumption has continued to grow at a robust pace. Sixty percent of consumption growth has come from an expanding population, and the rest from incomes rising enough to fuel spending on discretionary goods and services as well as basic necessities—all powered by rapid urbanization. Household consumption grew at a 3.9 percent compound annual rate between 2010 and 2015 to reach $1.4 trillion in 2015. To put these trends into an international context, Africa's consumption growth has been the second fastest of any region after emerging Asia, whose consumption growth was 7.8 percent.[13]

We project that household consumption will grow at a robust rate of 3.8 percent in the period to 2025 to reach nearly $2.1 trillion. Half of this additional growth will come from East Africa, Egypt, and Nigeria, but the geographic spread of consumption is changing. South Africa's share of consumption is set to decline from 15 percent in 2005 to 12 percent in 2025 and Nigeria's share from 26 percent to 22 percent over the same period. However, the share of regional consumption is projected to increase in East Africa from 12 percent in 2005 to 15 percent in 2025, and in Francophone Africa from 9 percent to 11 percent (Exhibit E6).

The substantial contribution of rising per capita spending has implications for patterns of consumption. Basic items such as food and beverages are expected to account for the largest share of consumption growth in the period to 2025, but discretionary categories are projected to be the fastest growing: 5.4 percent in the case of financial services, 5.1 percent for recreation-related activities, 4.4 percent for housing, and 4.3 percent for health care.

As per capita spending rises, it becomes even more important for consumer-serving companies to understand where their customers are and the evolution of their incomes, and then to tailor products and services accordingly.[14] We have broken African households into four income brackets: "basic needs" earning less than $5,000 a year; "emerging

[13] The emerging Asia grouping in this report includes seven countries, in line with the IMF definition: China, India, Indonesia, Malaysia, the Philippines, Thailand, and Vietnam.

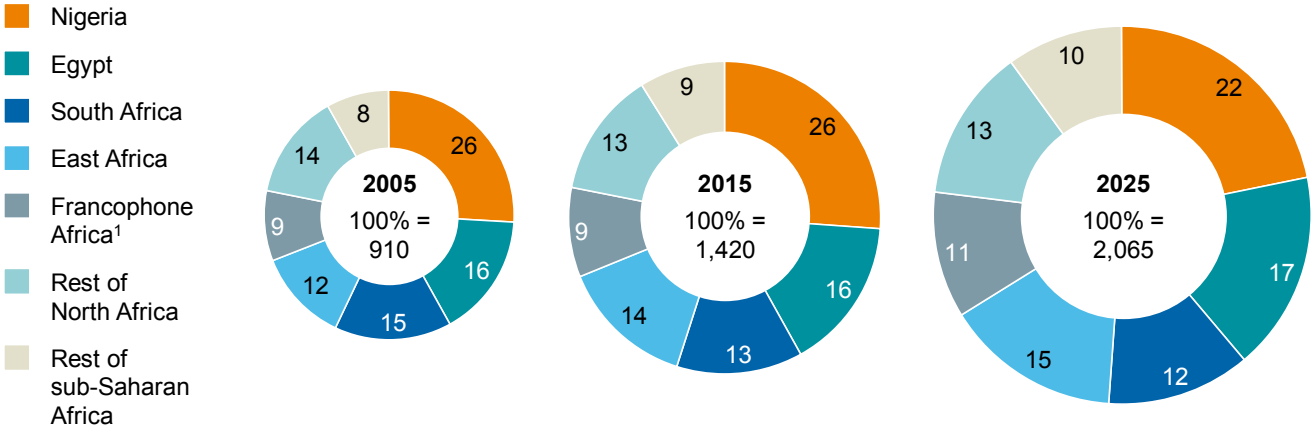
[14] For a global view, see *Urban world: The global consumers to watch*, McKinsey Global Institute, April 2016.

consumers" earning between $5,000 and $20,000; "global consumers" earning between $20,000 and $50,000; and "affluent" households earning more than $50,000.[15] Households earning less than $5,000 spend more than half their income on basic items. Such households account for 24 percent of households in South Africa and around half in Nigeria. That compares with around 20 percent in China. However, higher-income groups—global and affluent consumers—will spend at least 70 percent of their income on discretionary items by 2025, and those segments will account for 20 percent of the overall African population.

Exhibit E6

The regional share of household consumption is projected to grow by $645 billion by 2025

Total household consumption, 2005–25
%; $ billion, 2015 prices



1 Includes 15 countries in Central and West Africa; excludes North Africa and East Africa.
NOTE: Numbers may not sum due to rounding.

SOURCE: Oxford Economics: IHS; African Development Bank; McKinsey Global Institute analysis

Our analysis finds that four broad groups of African consumers will collectively account for $439 billion of the $645 billion in new consumption spending over the next decade (Exhibit E7).

- **Affluent consumers in North Africa and South Africa.** Affluent consumers, who are better off than middle class by OECD standards, will collectively spend an additional $174 billion a year by 2025, or 27 percent of total African consumption growth over this period. Their biggest spending categories will be housing, consumer goods, education, and transportation services.

- **Nigeria.** Africa's largest economy will remain the region's single largest consumer market, accounting for 15 percent of overall growth in consumer spending to 2025. New spending will be relatively evenly split among affluent households, which are expected to spend an additional $30 billion a year by 2025; global consumers, projected to spend $44 billion; and emerging consumers, with $28 billion of spending. The biggest spending categories will be food and beverages, housing, consumer goods, education, and transportation services.

[15] On 2005 international purchasing power parity basis.

- **East Africa.** Ethiopia, Kenya, Sudan, and Tanzania have two segments that will together account for 14 percent of Africa's overall consumption growth to 2025. Emerging consumers in these fast-growing East African markets will spend an additional $54 billion a year by 2025, while global consumers will spend $36 billion. Spending by these two groups is projected to grow rapidly at 5 percent and 7 percent a year, respectively, during this period. Food and beverages will be by far the largest spending category, although there will also be sizable opportunities in housing, consumer goods, and hospitality and recreation.

- **West and Central Africa.** Two consumer segments in five distinct geographic markets—Angola, Cameroon, Côte d'Ivoire, Democratic Republic of Congo, and Ghana—are expected together to account for 11 percent of Africa's consumption growth to 2025. These countries have roughly similar growth prospects and spending categories to those of East Africa. Emerging and global consumers, who are projected to spend more than $70 billion over this period, represent the largest share of new spending.

75
African cities to account for 49% of consumption by 2025

Cities are key to capturing Africa's consumer opportunity.[16] Per capita consumption in large cities is 79 percent higher than the average of these cities' host countries. In Nairobi, Kenya, and in the Nigerian cities of Abuja, Ibadan, Lagos, and Port Harcourt, per capita consumption is more than double the national average. The top three cities in Angola and Ghana account for more than 65 percent of national consumption. Consumption is highly concentrated in a small number of cities—just 75 cities across Africa accounted for 44 percent of total consumption in 2015; this will increase to 49 percent of total consumption by 2025.[17]

Consumer-facing companies will need to make sure they have a meaningful presence in each of Africa's emerging centers of consumption—Egypt, Nigeria, and East Africa—with a primary focus on the largest cities in those and other markets. Doing so will enable them to capitalize on the shifting geographic share of consumption. Given that Nigeria will account for more than 20 percent of African consumption in 2025, consumer-facing companies cannot afford to ignore the market even if the business environment is challenging. In all consumer markets, companies need to tailor their product and service offerings, and their pricing, to Africa's distinct consumer segments. Finally, informal retail channels are an important route to market in many countries, and companies will need to design their sales and distribution models to cater to these.

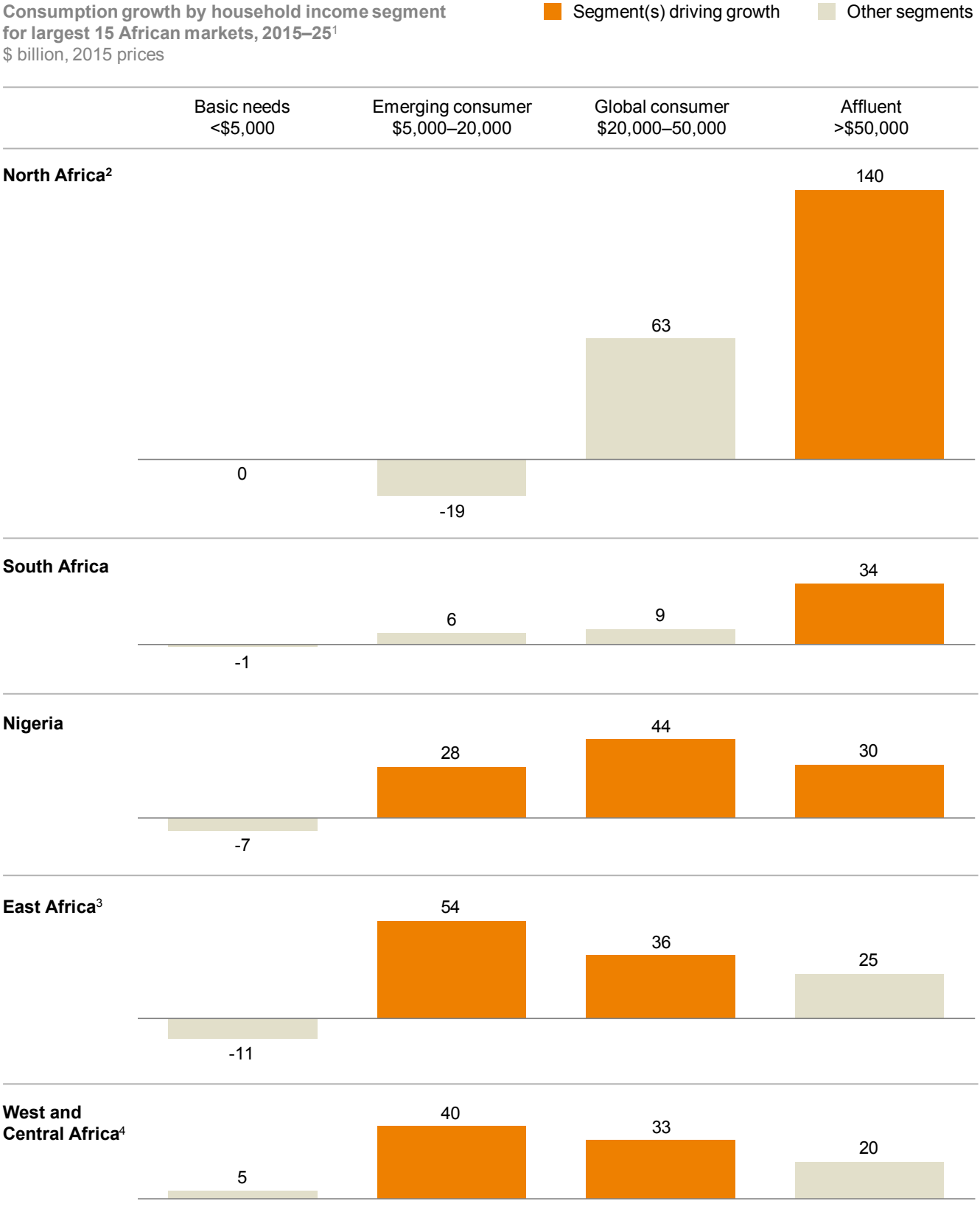
Cities are key to capturing Africa's consumer opportunity.

[16] Rural areas could be a second priority once the potential of urban areas is fully met, given the concentration of consumption in urban areas (approximately two-thirds) and the relatively higher cost to serve rural customers.
[17] McKinsey Global Institute Cityscope, 2015.

Exhibit E7

Different segments power growth in each consumer spending pool

Consumption growth by household income segment for largest 15 African markets, 2015–25[1]
$ billion, 2015 prices



1 These 15 largest African markets generated 89% of 2015 demand and will be responsible for 82% of consumption growth between 2015 and 2025.
2 North Africa includes Algeria, Egypt, Morocco, and Tunisia. Egypt will account for 62% of the region's growth in consumption.
3 East Africa includes Ethiopia, Kenya, Sudan, and Tanzania.
4 We focus on five major markets in West and Central Africa: Angola, Cameroon, Côte d'Ivoire, Democratic Republic of Congo, and Ghana.

SOURCE: Canback Global Income Distribution Database (C-GIDD); African Development Bank; Oxford Economics; IHS; McKinsey Global Institute analysis

Supplying materials, services, and capital goods to Africa's businesses

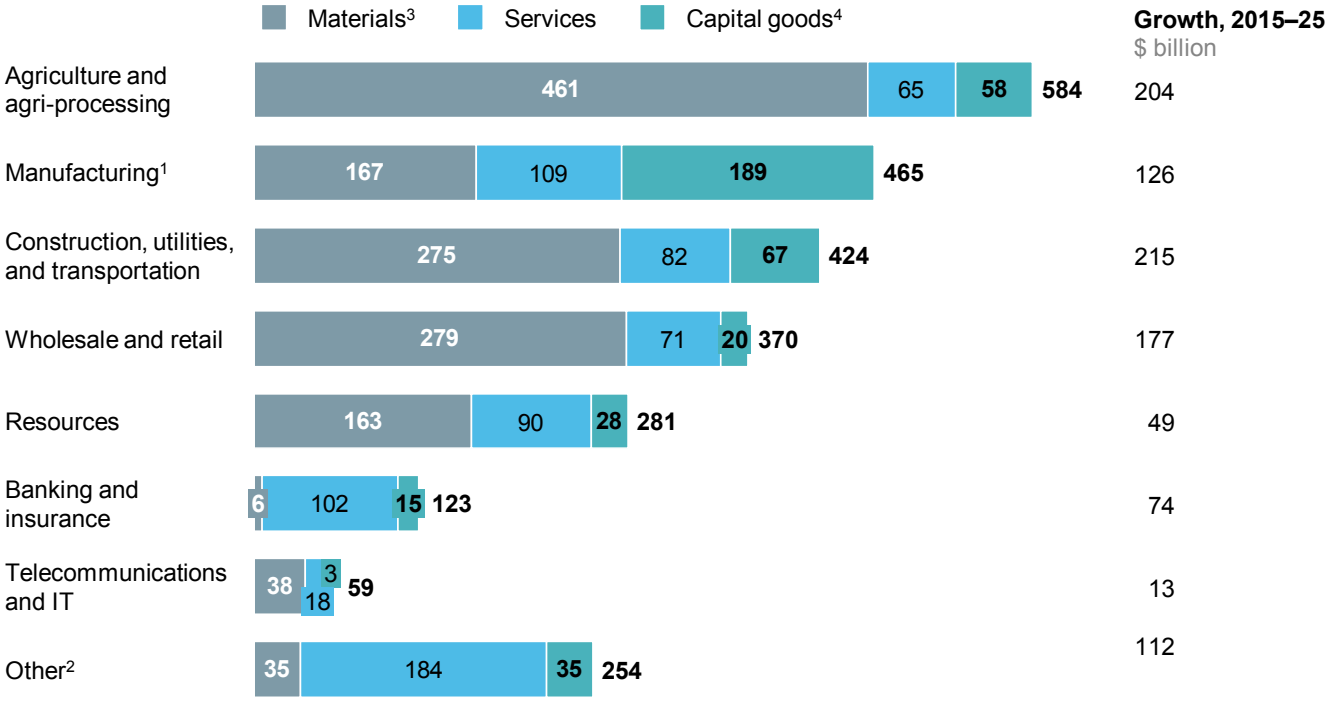
While the African consumer story has generated most headlines, the relatively unsung but rapidly growing business-to-business (B2B) market is an even larger spender. Companies in Africa spent some $2.6 trillion in 2015, 40 percent of it in Nigeria and South Africa. Africa's B2B spending is expected to increase to $3.5 trillion by 2025, with half of that total being spent on materials, 16 percent on capital goods, and the remainder on a wide range of services including business and financial services, transportation, and telecommunications. Services consumption is set to grow the quickest at 3.5 percent per year.

Companies selling to other businesses—like companies serving consumers—need a detailed understanding of trends at the sector level to be successful. Today, the largest-spending B2B sector is agriculture and agri-processing, and the spending largely goes toward input materials. This sector is expected to increase spending by an additional $204 billion over the next decade, reflecting both a growing population and rising incomes that are boosting demand for agricultural output and more sophisticated food products (Exhibit E8). The fastest-growing sectors are set to be financial services, construction, utilities and transportation, and wholesale and retail trade. B2B spending in the telecommunications, resources, and manufacturing sectors is likely to grow more slowly than in other sectors.[18]

Exhibit E8

Africa's business sectors have distinct spending profiles

Company spending by sector and category (excluding salaries), 2015
$ billion



1 Heavy, light, and R&D-intensive manufacturing.
2 Health care, other services, and smaller sectors.
3 Material costs directly attributed to the cost of production (as part of the finished product) and material costs that do not form a part of the finished product.
4 Defined as the average capital expenditure by a company in this sector (smoothing out the effect of large capital expenditure projects).
NOTE: Numbers may not sum due to rounding.

SOURCE: MGI African companies database; CIQ database; IHS; WCIS; BMI; Ovum; Yankee; McKinsey Purchasing and Supply Management Practice; McKinsey BMI Practice; McKinsey Oil and Gas Practice; McKinsey Global Banking Pools; McKinsey Global Institute analysis

[18] The slower growth of telecommunications services is based on declining long-term average revenue per user, even as mobile penetration rates continue to grow. The estimate is based on revenue for voice and data, not enterprise services or innovative products, which may yet emerge as a significant source of telecommunications growth.

60%
of B2B spending from companies with <$500 million annual revenue

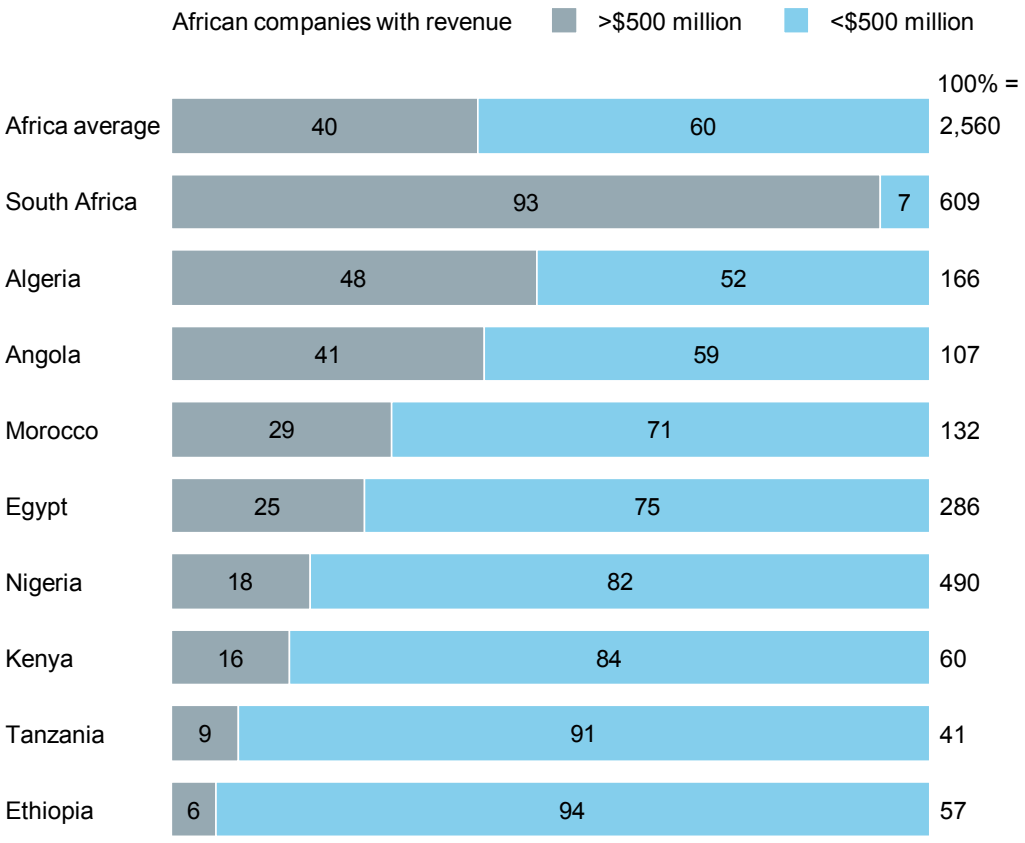
Even a view of sectors may not be sufficient to succeed; market intelligence needs to be detailed down to the level of individual companies. Across Africa, only 700 companies with annual revenue exceeding $500 million account for more than 40 percent of total B2B spending. In other words, 60 percent of B2B spending is by companies smaller than this revenue threshold (Exhibit E9). In Algeria, these large companies generate 48 percent of total B2B spending; in South Africa, large companies command more than 90 percent of the market. In such markets, it makes sense to target large firms. However, small companies dominate in other African economies. In Ethiopia, large companies account for less than 10 percent of B2B spending; in Nigeria and Kenya, it's less than 20 percent. The size of companies varies by sector, too. Large companies dominate in financial services, resources, and telecommunications, while agriculture, construction, utilities, and transportation sectors tend to have a higher share of smaller companies.

Given the predominance of smaller businesses in Africa, companies will need a clear plan for how to serve them, including tailored offerings, targeted sales forces, and distribution and supply chains appropriate to their needs. These smaller companies are well worth developing as customers. Many of these companies are growing rapidly and will make significant contributions to Africa's growth.

Exhibit E9

Smaller companies will account for most business spending in countries other than South Africa

Share of company spending by company scale, 2015
%; $ billion



NOTE: Numbers may not sum due to rounding.

SOURCE: MGI African companies database; CIQ database; IHS; WCIS; BMI; Ovum; Yankee; McKinsey Purchasing and Supply Management Practice; McKinsey BMI Practice; McKinsey Oil and Gas Practice; McKinsey Global Banking Pools; McKinsey Global Institute analysis

Nearly

2x

manufacturing output possible by 2025

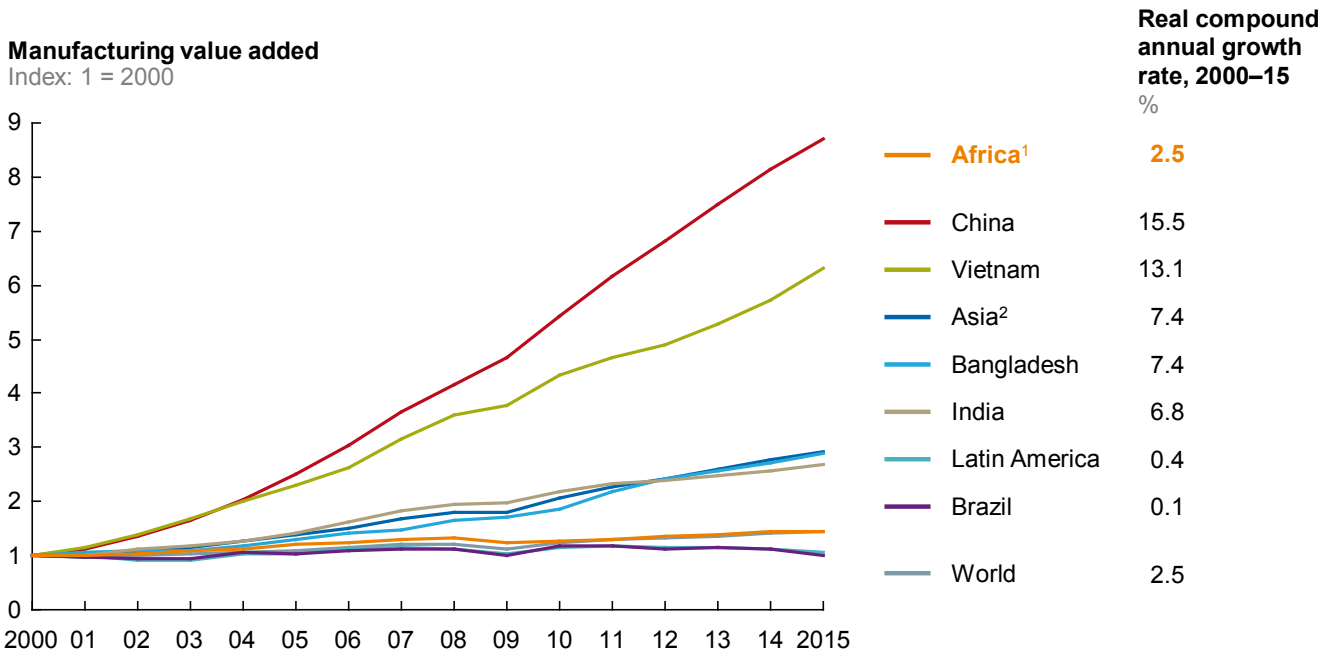
AFRICA HAS THE POTENTIAL TO ACHIEVE NEARLY $1 TRILLION IN MANUFACTURING OUTPUT IN 2025

Manufacturing is a vital engine of economic development, but Africa's economies overall have underperformed. As Africa's economies have grown and diversified over the past two decades, there has been a steady increase in manufacturing output—indeed, a rapid increase in Ethiopia and Tanzania, in particular. Nevertheless, Africa's growth in manufacturing value added of 2.5 percent a year between 2000 and 2015, while roughly in line with the global average, lagged far behind Asia's 7.4 percent (Exhibit E10). In 2015, Africa's total manufacturing output was worth around $500 billion and the vast majority of that was focused in five countries—Egypt, Morocco, Nigeria, South Africa, and Tunisia. Seventy percent of this production was focused on meeting domestic needs and was consumed in the country of manufacture; some 10 percent was traded within Africa, and just 20 percent was exported beyond Africa. Africa produced just 1.4 percent of global manufacturing exports in 2014, and its share has remained within the narrow band of 1.0 to 1.5 percent since 2000. By contrast, China grew its share of global exports from 4.5 percent in 2000 to 15 percent in 2014.

MGI estimates that, by 2025, Africa could nearly double its current manufacturing output of $500 billion to $930 billion. On current trends, output is set to rise to an estimated $643 billion by 2025. However, $287 billion could be added to that if African countries take decisive action to create an improved environment for manufacturers. The rewards of accelerated industrialization would be immense. There would be a positive step change in national wealth, tax receipts, productivity and skills, and balance of payments. An expanded and more productive manufacturing sector could also create six million to 14 million stable jobs over the next decade, an increase of 5 to 11 percent from 2015.

Exhibit E10

Since 2000, Africa's manufacturing value-added growth has equaled the global average but has lagged behind that of emerging Asian champions



1 Cameroon, Egypt, Kenya, Morocco, Nigeria, Senegal, South Africa, Tunisia, and Zimbabwe.
2 Bangladesh, China, Hong Kong, India, Indonesia, Japan, Malaysia, Pakistan, Philippines, Singapore, South Korea, Sri Lanka, Taiwan, and Thailand.

SOURCE: IHS; McKinsey Global Institute analysis

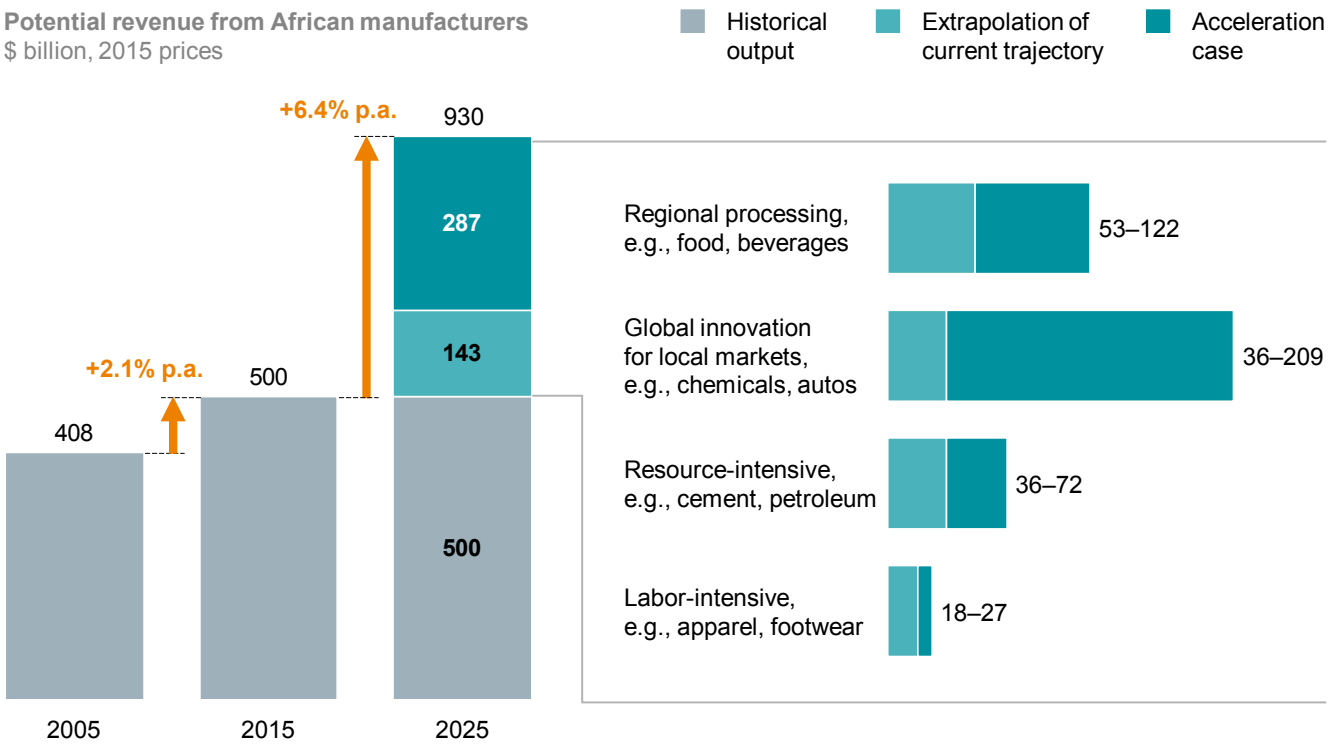
Four categories of products can contribute to a doubling of Africa's manufacturing output

Our analysis finds four categories of products that could increase output in the period to 2025 by $430 billion so that overall output approaches the $1 trillion mark (Exhibit E11).

The largest opportunity is in a category of goods we classify as global innovation for local markets, which includes vehicles and chemicals.[19] This opportunity will likely be feasible for only some African countries, primarily Egypt, Morocco, South Africa, and Tunisia. In these economies, manufacturers have already significantly increased their capacity in these areas. Morocco and Egypt expanded their automotive sectors by around 10 percent a year in real terms between 2004 and 2014. While South Africa's larger automotive sector grew more slowly, it still added nearly $5 billion in incremental revenue over that period, while its chemicals sector added more than $6 billion in incremental revenue. African manufacturers have an opportunity to supply more local demand and increase their exports in this category. By raising their share in the ten largest existing export markets to that of the highest quartile, Africa's four largest manufacturing nations could earn up to $209 billion in additional annual revenue in 2025—six times what they would achieve if historical growth rates remained in place.

Exhibit E11

Africa has an opportunity to triple historical manufacturing output growth rates, and to double output, in ten years



NOTE. Numbers may not sum due to rounding.

SOURCE: IHS; UNCTAD; McKinsey Global Institute analysis

[19] All goods in this category have similar traits. Competition is based on innovation and quality. There is high R&D intensity of between 5 and 25 percent. While some components are traded globally (with a trade intensity of 40 to 50 percent), there is a tendency toward greater regional assembly and production.

Reflecting the continent's growing population and rising household incomes, manufacturing of regional processing goods such as food and beverages is a second major opportunity. We estimate that local manufacturers could increase their revenue in such segments by $122 billion by 2025, almost triple the expected growth at the current trajectory. There is also an opportunity to earn up to $72 billion from resource-intensive products such as cement, and up to $27 billion more from labor-intensive goods such as apparel and footwear.

Three-quarters of the potential could come from meeting domestic demand, and the rest from enhancing exports

Three-quarters of the growth in potential output would come from meeting intra-African demand and substituting imports of manufactured goods, which today are at levels much higher than in peer regions. With consumer and B2B markets growing strongly, and rising sophistication among consumers and businesses, we can expect rising demand for a wide range of manufactured goods, including processed food and beverages, apparel, appliances, cars and trucks, fuel, construction materials, and industrial inputs. The other one-quarter could come from accelerating growth in niche manufacturing exports.

1/3
of food, beverages, and similar processed goods consumed in Africa is imported

There is a huge opportunity for import substitution (Exhibit E12). If Africa's firms and governments work together to unleash an industrial revolution across the continent, we estimate that the region can more than double its supply to intra-African markets by 2025, increasing annual revenue by $326 billion, three-quarters of the $430 billion potential increase in output.

Today, Africa imports one-third of the food, beverages, and similar processed goods it consumes. By contrast, member states of the Association of Southeast Asian Nations (ASEAN) import approximately 20 percent of such goods from outside their region, and the South American countries in the Mercosur trade bloc import about 10 percent.[20] About 60 percent of Africa's supply of global innovation goods, such as cars and chemicals, are imported—twice the level for Mercosur. Even in cement—a resource-intensive sector with abundant local raw materials—Africa imports 15 percent of its needs, compared with about 5 percent in ASEAN and Mercosur states.[21] In all these categories, African manufacturers can and should target significantly higher levels of local supply.

African manufacturers can and should target significantly higher levels of local supply.

About $100 billion could be added to Africa's manufacturing output if, as we have discussed, manufacturers move decisively to produce more in the global innovation category, as well as more labor-intensive tradable goods, and export these products. North African countries are already capitalizing on their proximity to Europe's vast consumer markets to expand their exports of apparel and other labor-intensive goods. Another helpful development has been the African Growth and Opportunity Act (AGOA), a US trade act that was introduced in 2000 and recently extended to 2025. It provides some 40 sub-Saharan nations with tariff-free access to the US market and a major cost advantage in thousands of product lines. For instance, AGOA makes various items of women's apparel from Ethiopia and Kenya sold to the United States 25 to 50 percent cheaper than prices for the same goods in European markets. Thus far, African companies have not fully capitalized on the

[20] ASEAN members are Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam. Mercosur comprises the economies of Argentina, Brazil, Paraguay, Uruguay, and Venezuela.

[21] On a tonnes basis.

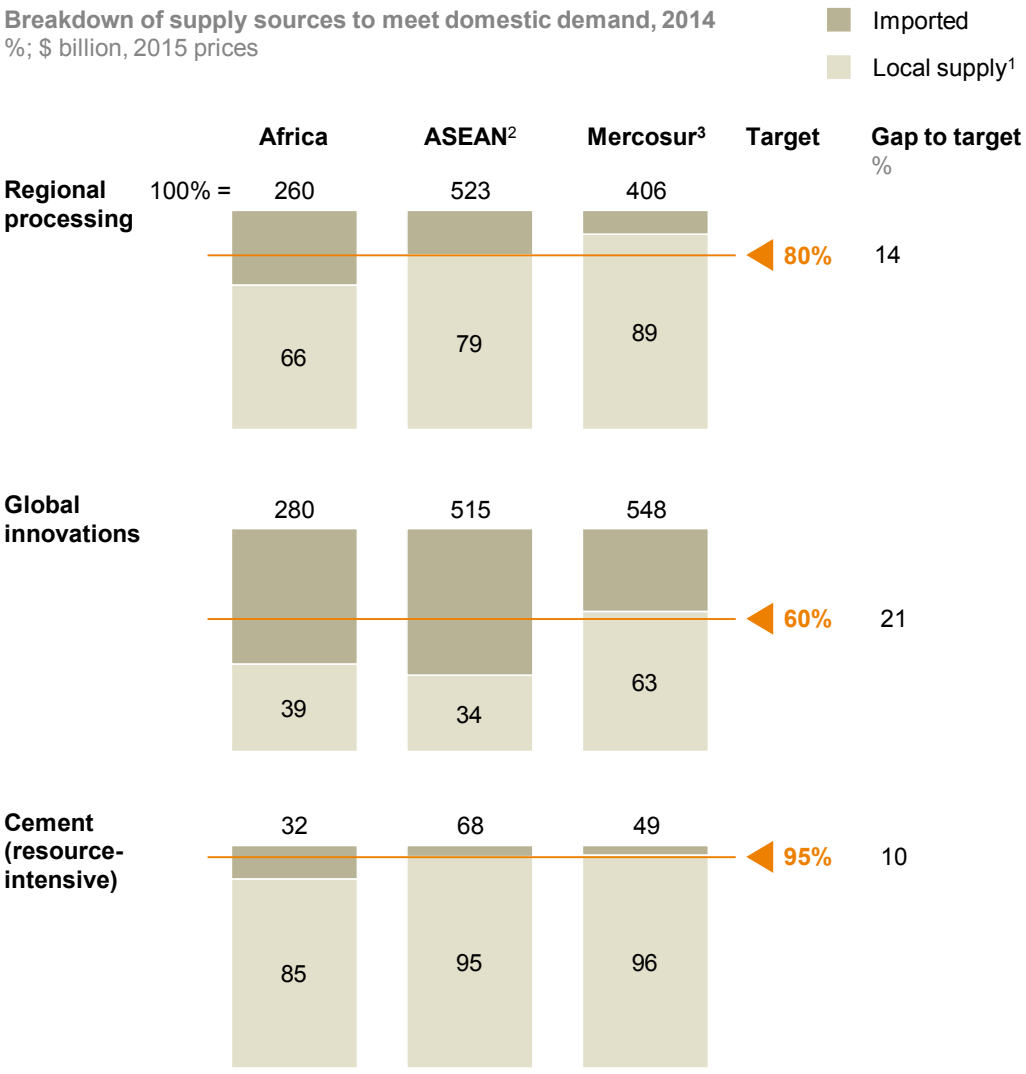
US opportunity. Indeed, despite AGOA, labor-intensive exports to the United States have declined by 6 percent a year over the past decade.

Achieving an African manufacturing revolution is essential, but it will not be easy. Our analysis suggests that Africa cannot achieve a meaningful increase in its share of global manufacturing purely on the basis of low labor costs. African economies need to boost competitiveness in manufacturing on seven dimensions: labor productivity, electric power, industrial land, movement of goods, business environment, financial systems, and tariffs. Depending on which categories of manufacturing offer the best opportunities for competitive growth in their countries, governments can prioritize specific interventions.

Exhibit E12

Africa imports a large share of products that could be manufactured within the region

Breakdown of supply sources to meet domestic demand, 2014
%; $ billion, 2015 prices



1 Includes domestic output and intraregional trade.
2 The Association of Southeast Asian Nations comprises Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam.
3 The Mercosur trade bloc comprises Argentina, Brazil, Paraguay, Uruguay, and Venezuela.
NOTE: Numbers may not sum due to rounding.

SOURCE: UNCTAD; WITS-UN Comtrade; *International Cement Review*; IHS; IMF; McKinsey Global Institute analysis

LARGE COMPANIES PLAY A CRITICAL ROLE IN GROWTH, AND AFRICA NEEDS MORE OF THEM

There is no shortage of exciting business opportunities across Africa, and the region is home to many fast-growing companies in a variety of sectors from resources to manufacturing. Nevertheless, it remains heavily underrepresented in the number of large companies that are the primary drivers of growth, investment, corporate tax revenue, and productivity in all economies. Africa needs more large companies to make a greater contribution to the economy. The success of many African companies demonstrates that bold growth strategies are already possible, and that other businesses in the region need not wait for governments to create an ideal environment in which to operate.

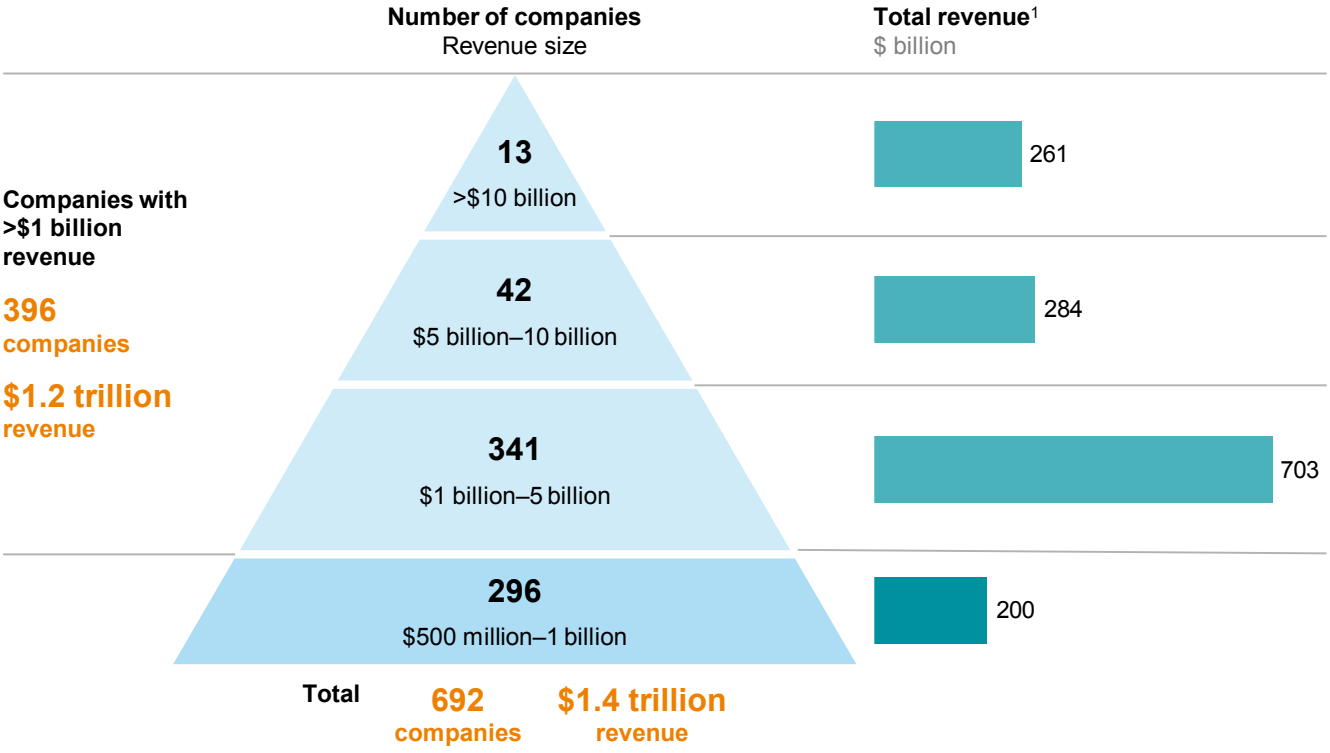
400
companies earn $1 billion or more annually in Africa

MGI's database of large African companies—the first of its kind—includes 700 companies with annual revenue of more than $500 million each (including 400 companies that earn more than $1 billion); collectively, the revenue of the 700 totals $1.4 trillion (Exhibit E13). The database shows that Africa arguably has a more diversified corporate landscape than might have been expected. For instance, we find that around two-fifths of the 700 companies are publicly listed, and that family-owned businesses account for only 10 to 20 percent of large companies. Twenty-seven percent of the 700 are multinational corporations, while the rest are large domestic companies; of this latter group, 17 percent of the 700 are state-owned enterprises (Exhibit E14). Many are increasingly pan-African in their operations and are active in increasingly diverse sectors. Seventy percent of revenue today comes from non-resources sectors. Successful African companies are emerging in sectors such as retail, financial services, and transportation services. Half of the continent's large companies are based in South Africa.

Exhibit E13

Around 700 companies in Africa account for $1.4 trillion in revenue

Breakdown of companies by revenue size, April 2016

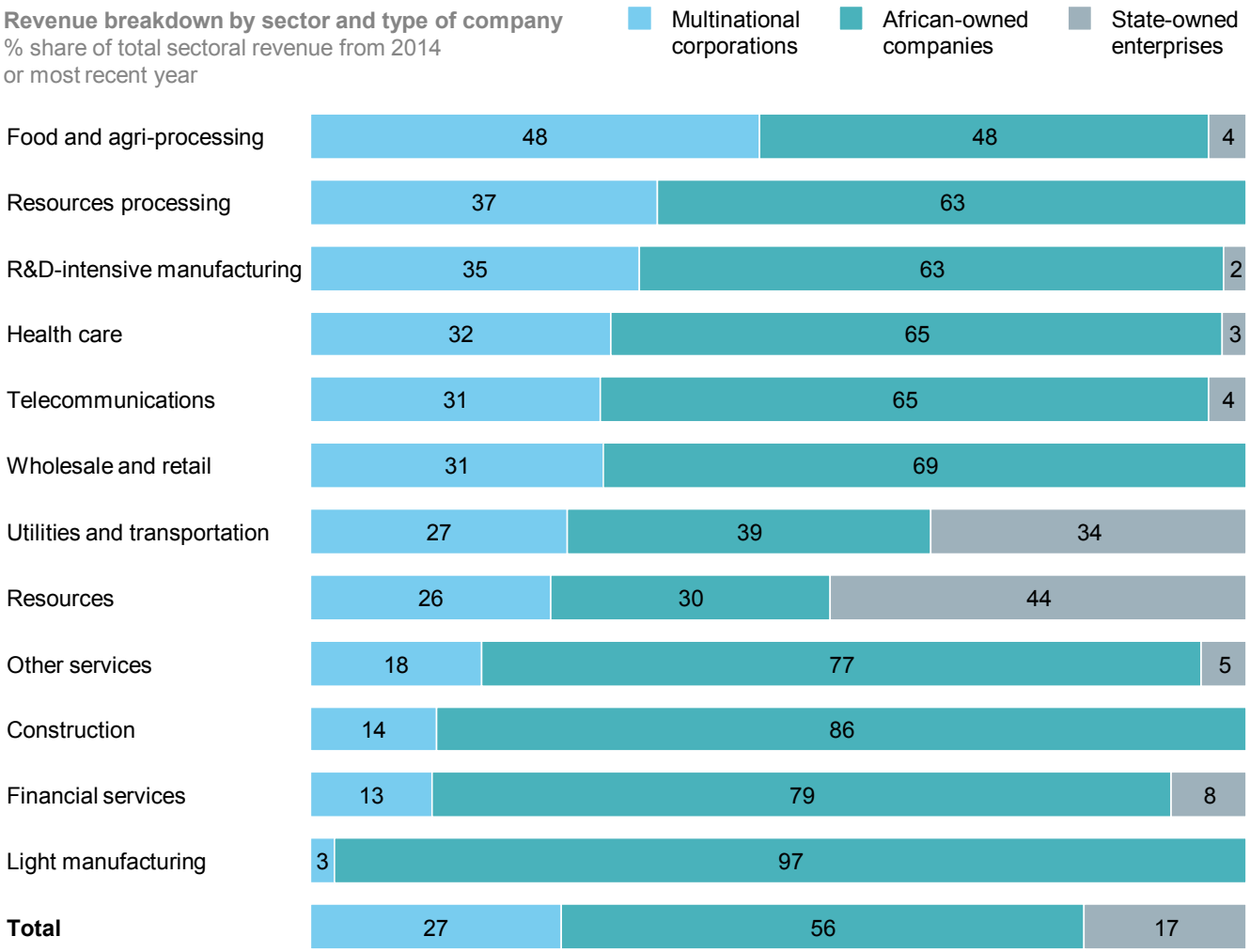


1 2014 or most recent data.

SOURCE: MGI African companies database; McKinsey Global Institute analysis

Exhibit E14

Corporate Africa comprises mostly local companies, followed by multinational corporations and state-owned enterprises


Revenue breakdown by sector and type of company
% share of total sectoral revenue from 2014 or most recent year
Multinational corporations
African-owned companies
State-owned enterprises
Food and agri-processing 48 48 4
Resources processing 37 63
R&D-intensive manufacturing 35 63 2
Health care 32 65 3
Telecommunications 31 65 4
Wholesale and retail 31 69
Utilities and transportation 27 39 34
Resources 26 30 44
Other services 18 77 5
Construction 14 86
Financial services 13 79 8
Light manufacturing 3 97
Total 27 56 17

NOTE: Numbers may not sum due to rounding.

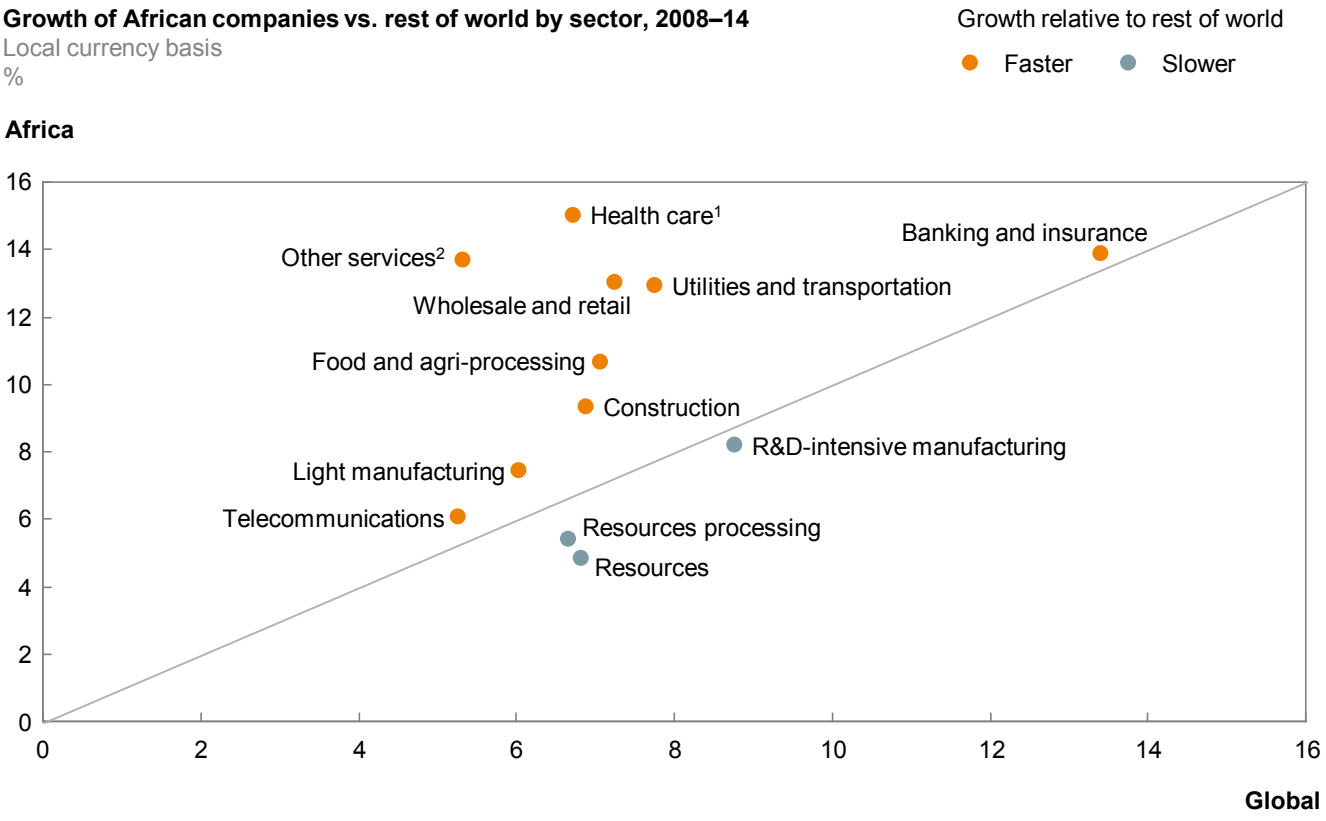
SOURCE: MGI African companies database; McKinsey Global Institute analysis

Our analysis finds that many African companies are successful. They grow faster than their peers in the rest of the world, and they are more profitable than these peers in most sectors (Exhibit E15). It is also worth emphasizing that six sectors are particularly promising for companies. In these sectors—wholesale and retail, food and agri-processing, health care, financial services, light manufacturing, and construction—large African companies were both more profitable and faster growing than global peers. In addition, there appears to be significant potential for further growth given the fact that these six sectors today remain relatively fragmented: consolidation could unleash even more opportunity for corporate Africa.

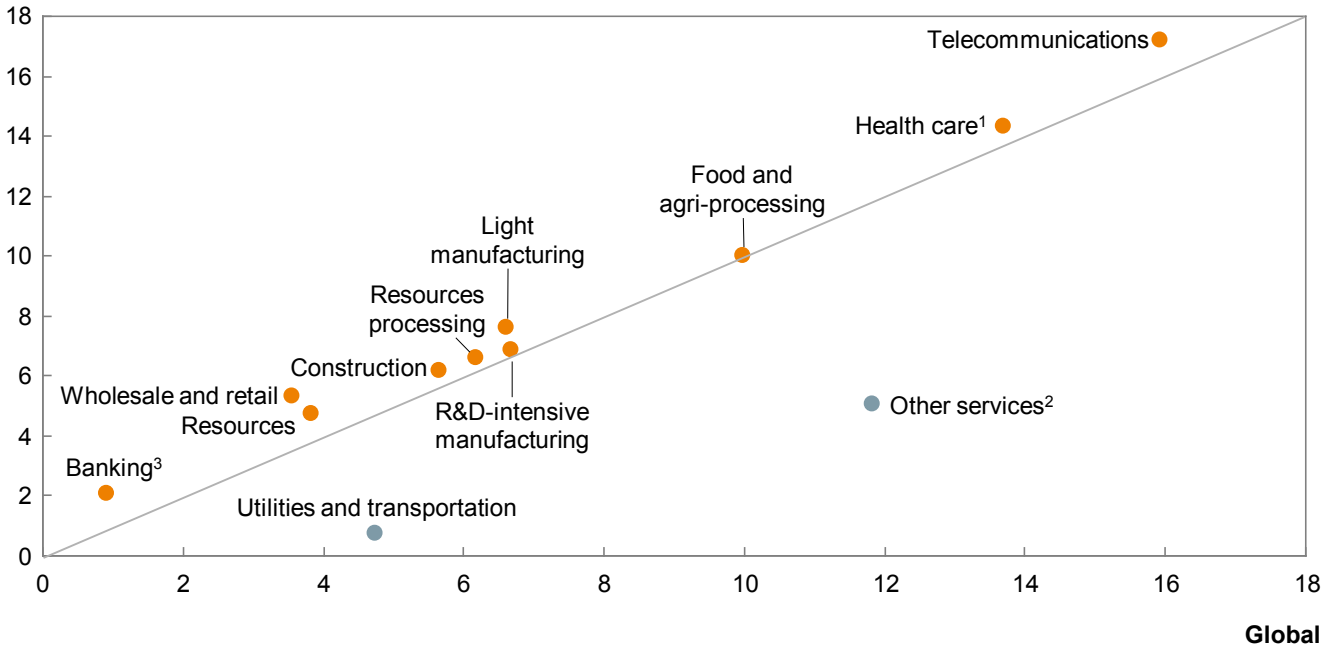
Exhibit E15

Large companies in Africa have tended to grow faster and have been more profitable than their global peers

Growth of African companies vs. rest of world by sector, 2008–14
Local currency basis
%



Profitability of African companies vs. rest of world by sector, 2013–14
Net operating profit less adjusted taxes (NOPLAT) as % of revenue



1 n = 4 for health care due to sector size and data availability.
2 Other services includes information technology, media, real estate, marketing, and other business services.
3 Banking profitability measured by return on assets in percentage terms.

SOURCE: McKinsey Corporate Performance Analytics; McKinsey Global Banking Pools; McKinsey Global Institute analysis

However, as a whole, Africa lags behind other emerging regions in its prevalence of large companies. It has about 60 percent the number one would expect if it were on a par with peer regions. The only exception to this situation is in South Africa, which has 9.6 companies per $10 billion in revenue, compared with 1.9 in North Africa and 1.1 in Nigeria. South Africa accounts for nearly half of all Africa's large companies, and North Africa accounts for one-fifth. There are too few large companies in the rest of the region.

Moreover, Africa's large companies are not as large as they need to be to make the most of promising sources of growth. The average large African corporation has annual revenue of $2.7 billion, compared with $4 billion to $4.5 billion in comparable emerging markets such as Brazil, India, Mexico, and Russia. Outside South Africa, Africa's firms earn less than half the revenue of their emerging market peers as a proportion of GDP. No African company is featured in the global Fortune 500, which ranks firms by revenue; Brazil and India, whose GDPs are similar to Africa's, each boast seven companies on that list, while China has 98. Taking numbers and size into account, the total revenue pool of large companies in Africa is one-third of what it could potentially be (Exhibit E16).[22]

The low level of consolidation in several high-growth sectors is an opportunity for large companies, but the flip side of this—a high degree of informality in many African economies—is a challenge. Formal firms in Africa must compete against informal or unregistered businesses that typically do not pay tax or comply with labor and other regulations; almost 40 percent of businesses rank competition against informal firms as a major constraint.[23] In contrast, the industry structure in some industries including telecommunications is highly consolidated, which makes it difficult for smaller players to grow. Overall, these patterns mean that companies need to be quite targeted in their expansion strategies.

Total revenue of large African companies is only **1/3** of its potential

Looking at the top 100 African companies, we find that their success has rested on three broad foundations: the vast majority have built growth by building a strong position in their home market before expanding into regional or pan-African markets; close to four-fifths of them have focused on a single sector rather than diversifying; and the large majority of them have driven growth through best-in-class execution and operations. The prevalence of innovation-driven strategies is much lower among Africa's largest companies than it is among their peers in other emerging regions, particularly Asia, where half of companies at some point prioritize technological innovation, innovative business models, or product excellence. Only 23 of the top 100 African companies have expanded through this approach, and only 7 percent of those that focused on excellent execution have later innovated. This is a concern. To take full advantage of Africa's potential, large firms will need to innovate more.

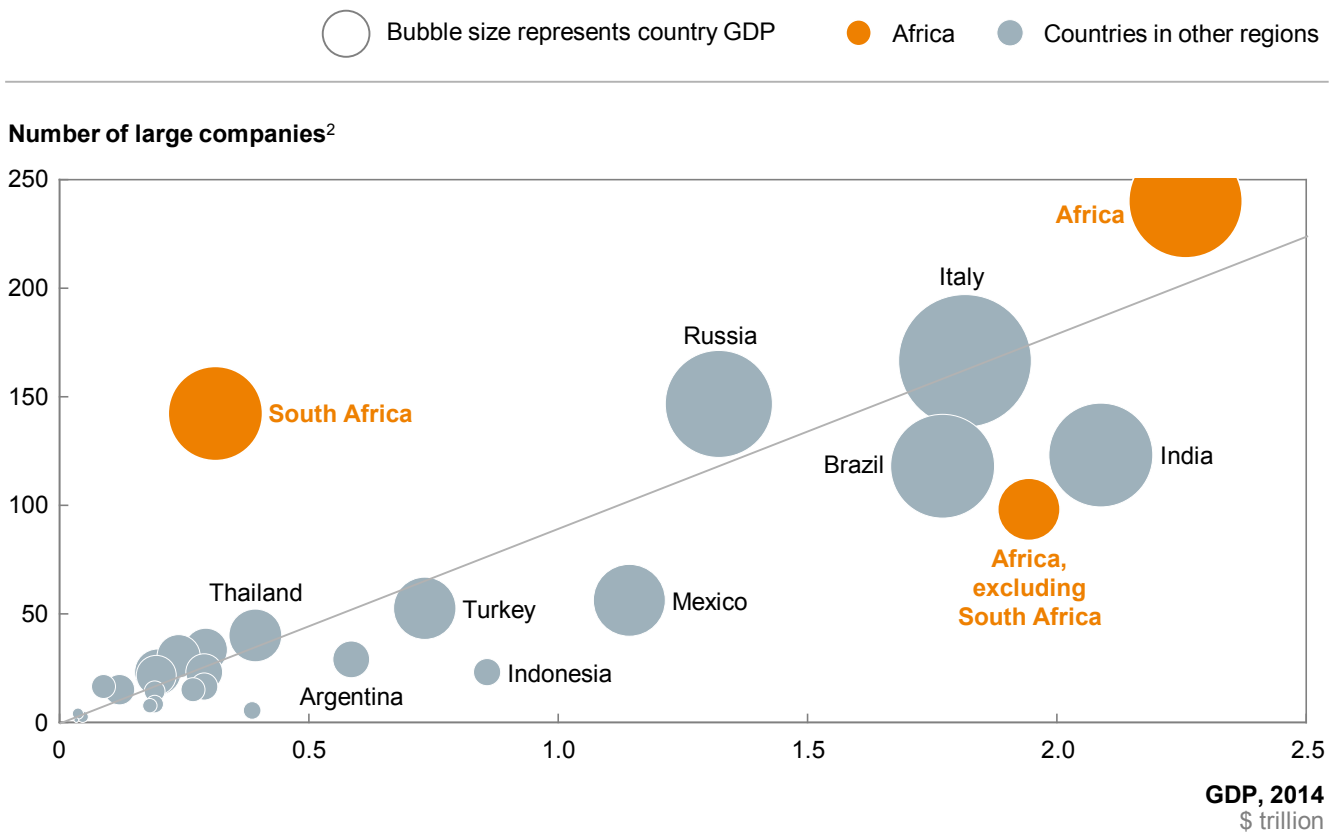
Companies looking to grow across the continent should build a strong position in their home market, use that as a base for expanding into markets well beyond their immediate region, adopt a long-term perspective and build the partnerships needed to sustain success over decades, be ready to integrate what would usually be outsourced, and invest in building and retaining talent. They should look for opportunities in six sectors MGI identifies with "white space"—wholesale and retail, food and agri-processing, health care, financial services, light manufacturing, and construction. These sectors are characterized by high growth, high profitability, and low consolidation.

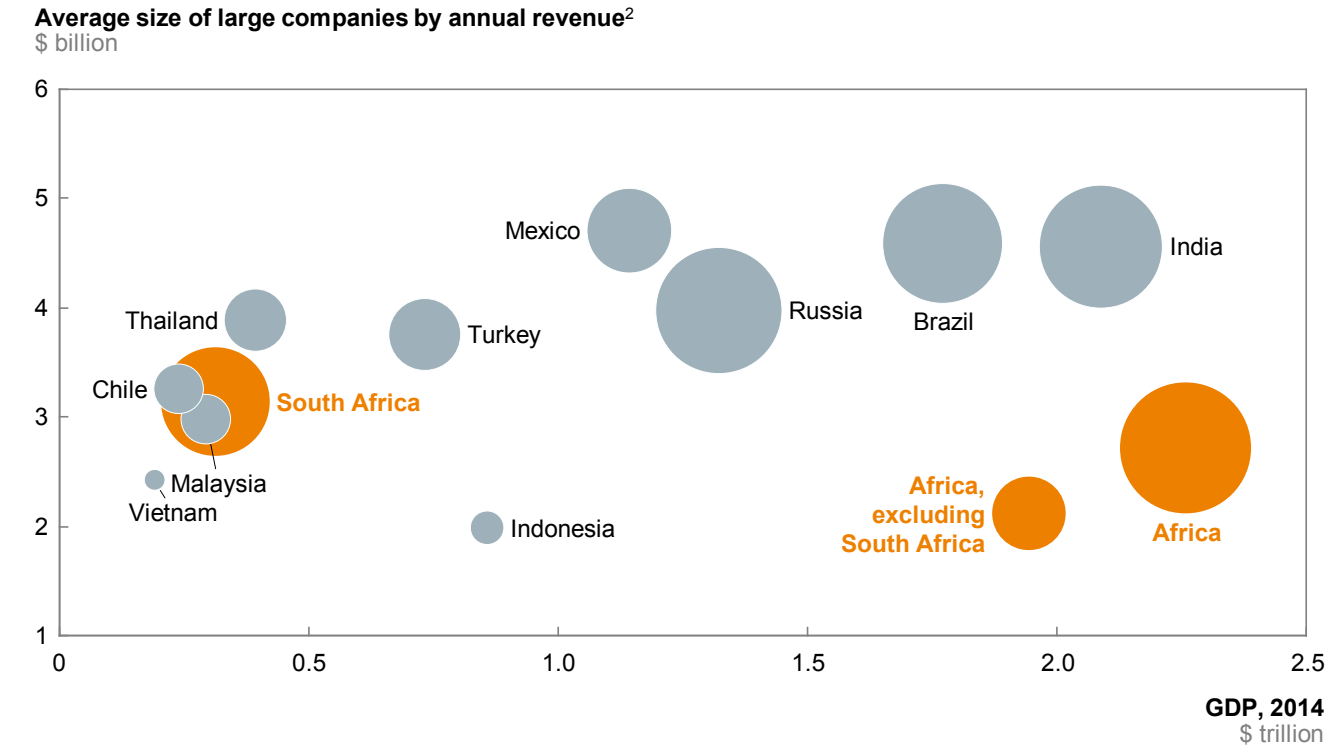
[22] These estimates exclude South African companies.

[23] This is the worst ranking of all regions globally. *Enterprise surveys*, World Bank, 2016.

Exhibit E16

Corporate Africa's revenue pool[1] is a third of what it could be because there are fewer large companies and they are smaller than those in other emerging markets





1 Excluding South Africa.
2 In this analysis, large companies are defined as those with more than $1 billion in revenue per year. These analyses exclude multinational corporations and state-owned enterprises.

SOURCE: McKinsey Companyscope; MGI African companies database; McKinsey Global Institute analysis

GOVERNMENTS SHOULD CONSIDER SIX IMPERATIVES TO ACCELERATE, UNDERPINNED BY TRANSFORMED LEADERSHIP AND GOVERNANCE

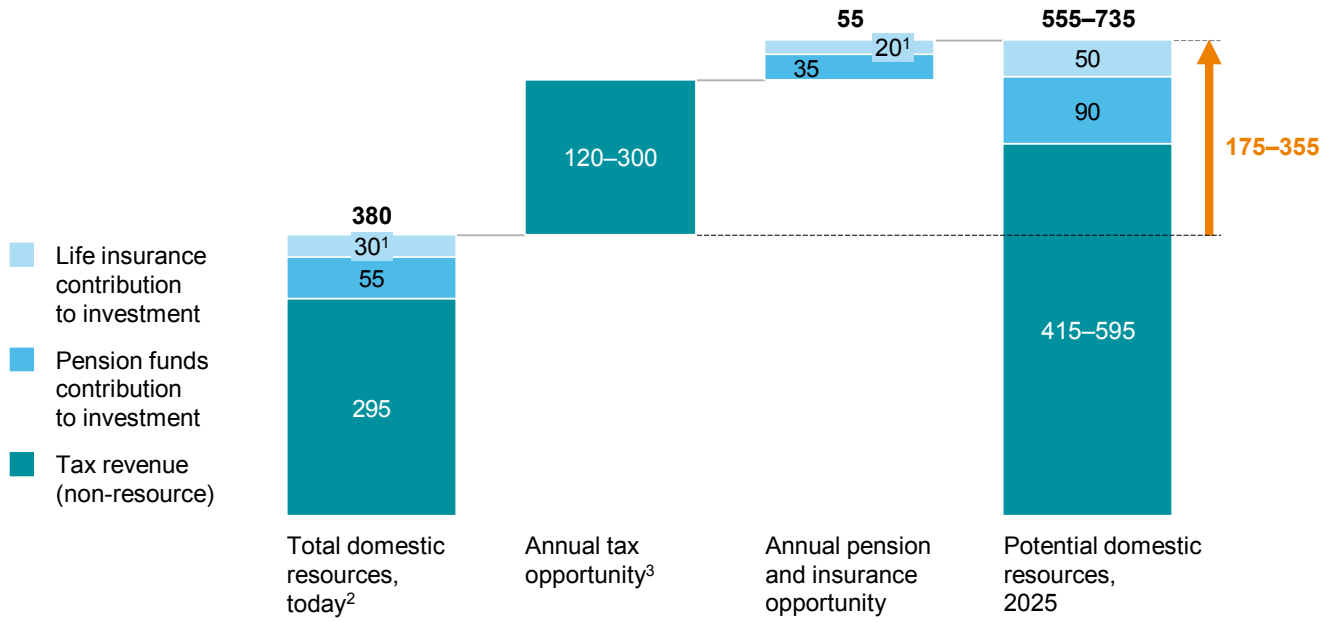
African governments face many challenges, including pressure on public finances, a slowdown in foreign investment, and the need to provide housing, infrastructure, and services in fast-growing cities. At the same time, challenging global economic conditions put pressure on African companies and reinforce the imperative to develop an environment that enables the dynamism of the private sector and boosts investment and productivity. The continent's growing population offers a potential demographic growth dividend, precious in a broadly aging world, but African economies need to be able to create opportunities for an expanding workforce and ensure that their energy is mobilized to fuel economic activity. To help African economies meet these challenges and make the most of strong long-term fundamentals, governments can prioritize action in six areas and address one overarching imperative—to improve governance. The six priorities are the following.

1. **Mobilize domestic resources.** Africa needs to take bold steps to mobilize more of its own funding to finance its development—an urgent imperative given weakening currencies, rising debt-to-interest-rate spreads, and higher volatility in capital inflows. We find that two levers are available to governments to mobilize an additional $175 billion to $355 billion in domestic resources: enhanced tax collection, and increased stimulation of domestic investment via state and large corporate pension funds and increased penetration of insurance products (Exhibit E17).

Exhibit E17

Africa can mobilize $175 billion to $355 billion of domestic resources, including tax revenue, and increased pension and insurance penetration

Potential increase in African domestic resources by 2025
$ billion



1 Excludes the contribution of group life premiums, estimated to be 40% of total life insurance premiums; figure based on South African data. This type of premium is excluded because it is short term and therefore not amenable to long-term investment.
2 Tax estimates from 2013; insurance and pension fund estimates from 2014.
3 No official estimates for potential tax revenue are publicly available. The assumption (based on available literature, and discussions with tax authorities and experts) of the share of tax not collected due to failure to file, underreporting, or late payment is likely to be as much as 30 to 50 percent of total potential tax revenues in Africa. Resource rents are excluded.
NOTE: Numbers may not sum due to rounding.

SOURCE: National tax experts; African Economic Outlook; Swiss Re Sigma; Africa Re; World Development Indicators, World Bank; OECD; McKinsey Global Insurance Pools; McKinsey Public Sector Practice; McKinsey Global Institute analysis

Annual infrastructure investment needs to double to

$150B

in period to 2025

2. **Aggressively diversify economies.** Although Africa's economies have diversified to an extent, more is needed to overcome economic vulnerabilities. Compounding this, while the business environment in Africa has improved a great deal over the past 20 years, there is still a long way to go. In the World Bank's 2016 *Doing business* report, only seven African states—Botswana, Mauritius, Morocco, Rwanda, Seychelles, South Africa, and Tunisia—placed in the top half of the ranking. Governments can set out strategies to encourage growth in high-potential sectors in close cooperation with business, based on a clear understanding of their countries' comparative advantages—as Morocco has done in the cases of manufacturing, agri-processing, and business process outsourcing. Industrial policy, in particular, could focus on productivity, market access (regional and international), and integration into global supply chains. Any successful diversification strategy needs to be guided by a long-term national vision with transparent objectives, which sends a clear signal to investors in focus sectors, and guides resource allocation and trade-offs. To support diversification, governments can also take steps to improve the enabling environment for business, including by strengthening transportation and electric power infrastructure, increasing openness to foreign investment, and reviewing new-business registration, bankruptcy laws, and other regulations key to a healthy business environment. Governments should also consider how to increase the attractiveness of sectors with comparative advantage for investors through proactive marketing, a dedicated investment agency, and support for investors even after a deal is signed.

3. **Accelerate infrastructure development.** Poor infrastructure, including electricity provision, and poor transportation links contribute to the lack of scale among Africa's companies and hinder regional integration. Africa's spending on infrastructure has doubled from an average of $36 billion in 2001–06 to $80 billion in 2015 in nominal terms but, as a share of GDP, infrastructure investment has remained at around 3.5 percent, less than the 4.5 percent that MGI research has found is necessary each and every year until 2025. In absolute terms, this means doubling annual investment in African infrastructure to $150 billion. Government needs to develop bankable projects, ensure adequate financing, put in place effective public-private partnerships, and optimize spending. Other agencies—both public and private—also have a role to play in delivering infrastructure and attracting or providing funding.

4. **Deepen regional integration.** One of the major thrusts of government effort has to be continuing to help deepen regional integration. Investors are attracted to large markets, and integration is needed to help African companies build scale. Driving closer regional integration is also important for unleashing faster industrialization given that, as we have noted, three-quarters of the growth potential in Africa's manufacturing output lies in meeting demand within the continent. Unlike the large integrated markets of China, Brazil, and the United States, Africa is a patchwork of more than 50 mostly small economies with only a limited degree of economic integration and political collaboration. That helps explain why so many large African companies have focused their expansion on their immediate regions. Africa's economic fragmentation has domino effects on companies' ability to source or sell inputs along supply chains in multiple sectors. There are few manufacturing and services hubs as production is highly dispersed across the continent, hindering the formation of new businesses, limiting companies' ability to specialize, and reducing their international competitiveness. African governments can act on three fronts to strengthen regional integration: (1) help corporate Africa to build scale by reducing the time it takes for goods to cross borders, continuing to lower tariffs between countries, and implementing double taxation agreements; (2) drive closer integration of regional capital markets to help attract FDI; and (3) encourage the movement of business people between African countries through simplified visa requirements.

5. **Create tomorrow's talent.** In several global surveys, Africa-based companies have reported major challenges in attracting and retaining the talent they need to run and grow their businesses. The challenge is heightened by the "brain drain": by one measure, more than 10 percent of Africa's highly educated professionals live and work on other continents.[24] Despite this, Africa faces a significant gap in post-secondary education and training options with approximately six million slots available each year for its 49 million annual high school graduates.[25] In vocational training, our analysis suggests that the continent would need to enroll approximately 33 million secondary school students per year in vocational programs by 2025, up from four million in 2012. Governments have a key role to play in ensuring that educational and training systems build these work-relevant skills, and that students are aware of, and encouraged to enter, these vocations. The private sector also needs to act, building on the skills development programs that several of Africa's most successful companies have put in place.

6. **Ensure healthy urbanization.** Africa's cities will be home to 190 million more people over the next decade. This rapid urbanization has the potential to bring significant economic benefits—provided governments prepare for it now. They need to improve planning processes, build more affordable housing, design and invest in efficient mass transit systems, increase access to electricity, and install more information and communication technology infrastructure.

Delivering on these six priorities will require a step change in the quality of Africa's public leadership and institutions. All these imperatives require the vision and determination to drive far-reaching reforms in many areas of public life—and a capable public administration with the skill and commitment to implement reforms. This will be particularly important as Africa moves to catch up with other regions in the strength of its business climate and its effectiveness in fighting corruption, measures in which it currently placed last in world rankings. Transforming public administration and governance does not have to be complex. Successful countries have put in place simple, quick, yet high-impact measures that have tackled challenges in operations, transparency, and compliance to remove business stresses and minimize opportunities for corruption—without requiring a systemic overhaul.

•••

The turbulence—both economic and political—in parts of Africa in recent years has doubtless been a shock, but it has not derailed the continent's growth story. The International Monetary Fund (IMF) still forecasts that Africa will be the second-fastest growing region in the world between 2016 and 2020 with annual growth of 4.3 percent. But what the past five years have proved is that Africa's diverse economies—its economic lions—now need to improve their fitness in order to make the most of their undoubted long-term growth potential and continue their march toward prosperity. The urgent imperative now is to accelerate investment and productivity, encourage continued economic diversification, make further improvements to Africa's business environment, nurture the continent's talent, and continue the process of regional integration.

[24] *World migration in figures*, OECD and UN Department of Economic and Social Affairs, October 2013.
[25] *State of education in Africa report 2015*, Africa-America Institute, 2015.

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1. AFRICA'S GROWTH PATHS HAVE DIVERGED, BUT LONG-TERM FUNDAMENTALS REMAIN STRONG

The McKinsey Global Institute's 2010 report on the African economy—*Lions on the move: The progress and potential of African economies*—found that there had been a quickening of Africa's economic pulse and a new commercial vibrancy. Real GDP had grown at 4.9 percent a year between 2000 and 2008, more than twice its pace in the 1980s and 1990s, making Africa one of the most rapidly growing regional economies in the world. Growth in 27 of the 30 largest economies accelerated compared with the previous decade, and Africa was attracting increasing inflows of FDI, particularly in sub-Saharan Africa. Collectively, the GDP of Africa's 50-plus individual economies stood at $1.6 trillion in 2008, roughly equal to that of Brazil or Russia. While the global race for commodities supported this expansion, Africa's economic renaissance reflected much more than a resources boom. The continent was enjoying increased macroeconomic and political stability, widespread microeconomic reforms, and improved productivity supported by rapid urbanization.

3.3%
annual real GDP growth 2010–15 vs. 5.4% in 2000–10

But over the past five years, growth has been significantly slower. Between 2010 and 2015, Africa's overall real GDP growth averaged just 3.3 percent.[26] This deceleration of growth, of course, reflects more challenging global economic conditions. However, it also exposes a divergence in the growth paths of economies within Africa. Two groups of economies—Africa's oil exporters and North African economies that were part of the Arab Spring democracy movement—experienced sharp declines in growth, while others continued to accelerate their GDP expansion. Several warning lights have been flashing across the continent, including deteriorating budget and current-account balances, slowing rates of FDI and domestic savings, and stagnating human capital development.

Africa clearly faces challenges in the short and even medium term, and businesses and policy makers will need to work hard to overcome them. But across the continent, long-term fundamentals—including Africa's young and growing labor force and rapid urbanization—remain sound. The region's GDP overall is still growing more quickly than the world average, and it is expected to accelerate over the next five years, making Africa the second-fastest growing region in the world after emerging Asia.[27]

AFRICA'S OVERALL GDP GROWTH RATE HAS SLOWED OVER THE PAST FIVE YEARS

Africa's growth has decelerated significantly over the past five years. Between 2000 and 2010, the continent achieved average real annual GDP growth of 5.4 percent, adding $78 billion annually to GDP in 2015 prices. But between 2010 and 2015 the rate of growth slowed to 3.3 percent, or $69 billion a year (Exhibit 1). Annual productivity growth has also weakened, from 2.3 percent in 2000–10 to 0.8 percent from 2010 to 2015 (Exhibit 2).[28] Productivity improvements therefore accounted for only 20 percent of the continent's growth over the past five years, with the rest coming largely from an expanding labor force.

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[26] All sources of data used in this report, together with details on our methodology, can be found in the appendix at www.mckinsey.com/mgi.

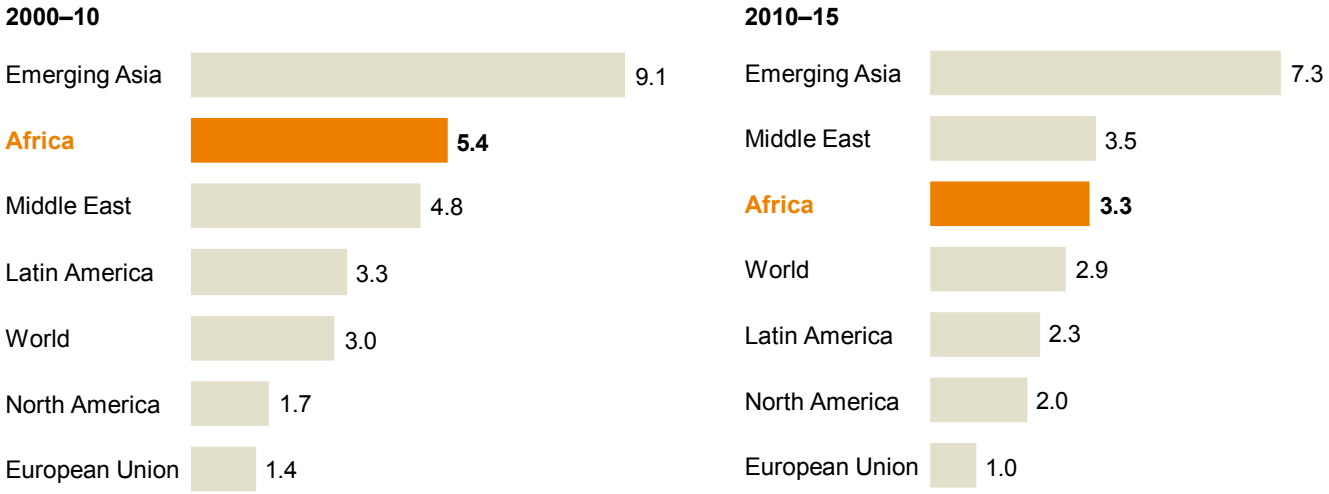
[27] In April 2016, the IMF forecast real annual GDP growth for Africa of 4.3 percent between 2016 and 2020. See *World economic outlook: Too slow for too long*, IMF, April 2016.

[28] This figure applies to 25 countries for which productivity data are available. Together they account for 92 percent of Africa's GDP.

Exhibit 1

Like other emerging economies, Africa as a whole has experienced a growth slowdown over the past five years

Measured real GDP growth
Compound annual growth rate
%

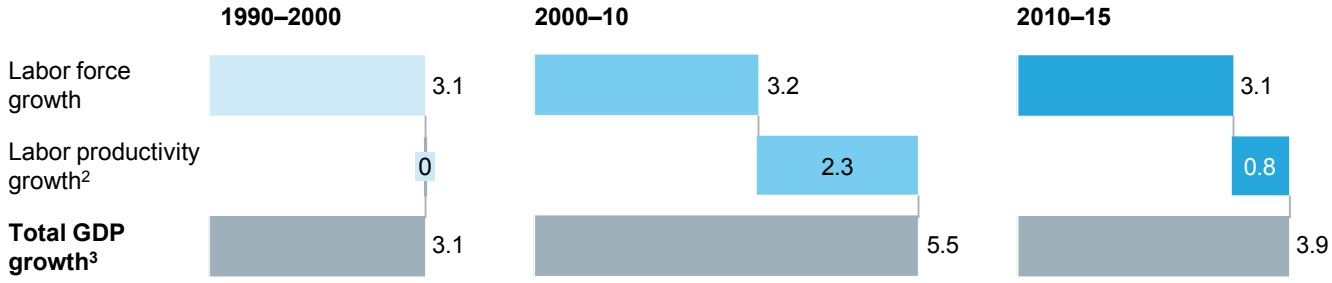


SOURCE: *World economic outlook: Too slow for too long,* IMF, April 2016; McKinsey Global Institute analysis

Exhibit 2

Africa's labor force generated ~80 percent of GDP growth from 2010 to 2015; productivity growth slowed

Decomposition of Africa's real GDP growth for a subset of 25 countries[1]
%



1 Estimated from data for 25 African countries generating 92% of GDP; excludes Libya due to negative growth.
2 Estimated using labor productivity per person employed in 2014 $.
3 The real GDP growth rate for 52 economies during these periods was: 3.1% from 1990 to 2000, 5.4% from 2000 to 2010, and 3.3% from 2010 to 2015.
NOTE: Numbers may not sum due to rounding.

SOURCE: Conference Board Total Economy database, September 2015; *World economic outlook: Too slow for too long*, IMF, April 2016; McKinsey Global Institute analysis

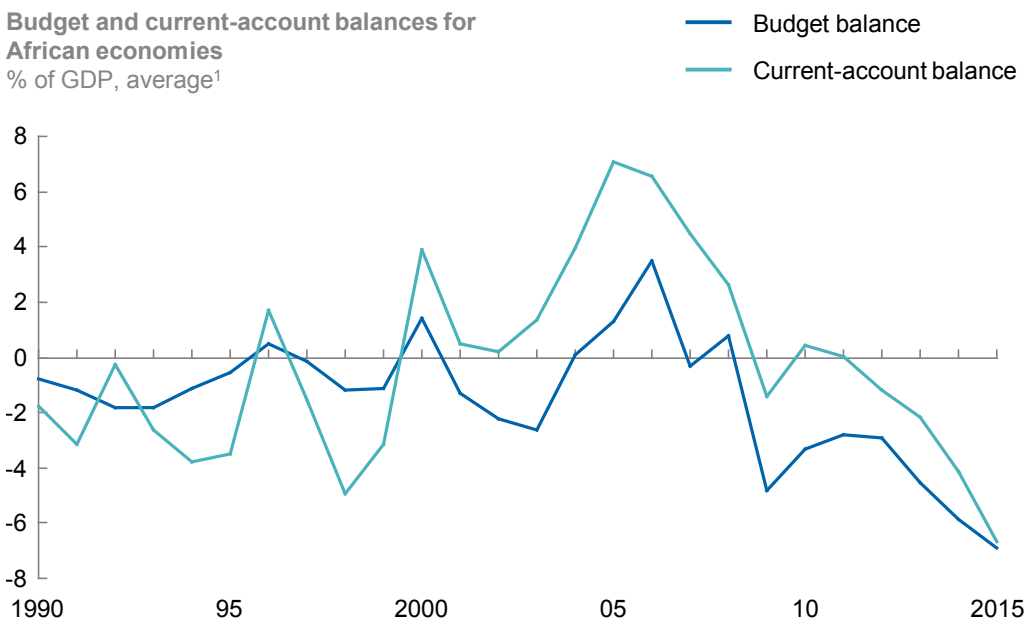
A number of factors have weighed on growth across Africa, not least the global economic slowdown—and, specifically, slowing growth in China—and the associated decline in the prices of several key commodity exports. Between 2011 and 2015, the crude oil price fell by half, while copper prices and wheat prices fell by more than one-third. At the same time, hard-won improvements in macroeconomic stability in Africa have come under pressure. Debt forgiveness in the early years of this century had helped many African countries improve their budget balances. The absence of this stimulus over the past decade, combined with steep declines in tax receipts from commodity exports, has turned surpluses into deficits. Across Africa, the average budget deficit in 2015 exceeded

6 percent (Exhibit 3). Even in economies that are not major resource exporters, their fiscal health has sharply deteriorated and the average budget deficit has more than doubled, from 1.6 percent of GDP in 2010 to 4 percent in 2015. Current-account balances as a proportion of GDP have fallen across the continent by an average of five to six percentage points since 2010.

Exhibit 3

Macroeconomic stability has deteriorated across Africa

Budget and current-account balances for African economies
% of GDP, average[1]



1 The budget balance is based on the average of 29 of the largest 30 economies in Africa excluding Equatorial Guinea, where pre-2000 data are patchy; the current-account balance is based on the average of 27 of the largest 30 economies excluding Equatorial Guinea, Namibia, and Zambia, for which data are missing.

SOURCE: *World economic outlook: Too slow for too long, IMF,* April 2016; McKinsey Global Institute analysis

At the same time, FDI and other capital flows into Africa have leveled off, signaling an abrupt end to the boom years of 2005 to 2010 when foreign capital inflows tripled (Exhibit 4). From 2010 to 2014, Africa-bound FDI rarely bettered its peak period between 2007 and 2009, but increased portfolio and other investment flows lifted overall growth in capital inflows to 7 percent per year. This was disappointing at a time when global investment was still growing. The continent's overall investment level has remained at around 22 percent of GDP since 2010, but savings have fallen sharply as a share of GDP from a peak of 27 percent in 2005 to 16 percent in 2015.

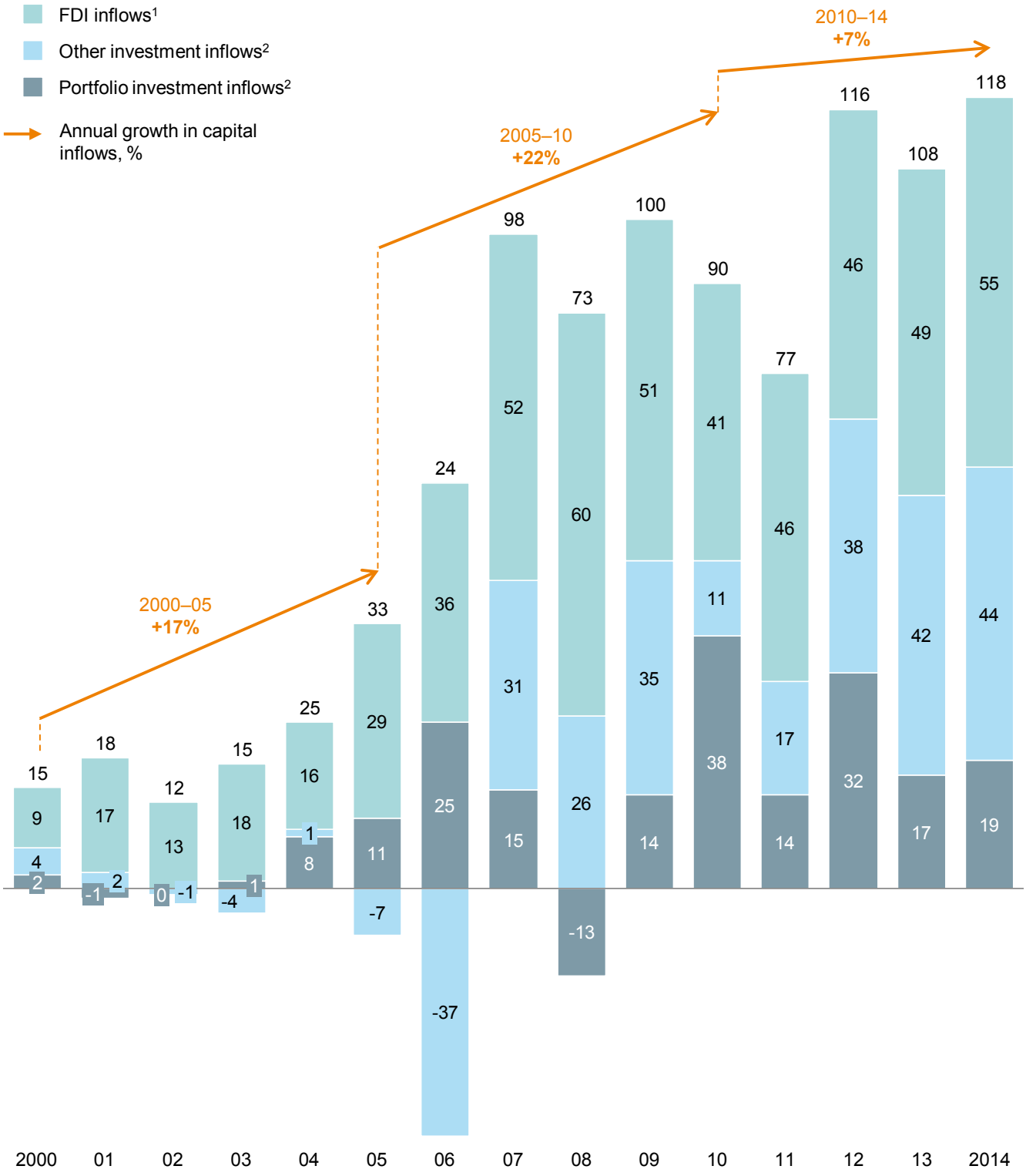
It has become increasingly difficult for African countries to compensate for stagnant foreign investment and falling savings by tapping global debt markets. The continent's average debt-to-GDP ratio rose from 40 percent in 2011 to 50 percent in 2015. Although this ratio is still relatively low by global standards, Africa's sovereign debt yields have risen sharply as governments have come under increased fiscal pressure. For instance, between 2014 and 2015 yields increased from 6.6 percent to 7.4 percent in Nigeria, from 4.6 percent to 6.3 percent in Egypt, and from 7.0 percent to 10.9 percent in Zambia (whose fiscal health is closely tied to the copper price).[29]

[29] Bloomberg.

Exhibit 4

Capital inflows to Africa were increasing rapidly driven by rising foreign direct investment, but have slowed since 2010

African capital inflows by type
$ billion



1 Includes all African economies.
2 Includes 44 African countries. Portfolio investment inflows include equity and debt; portfolio equity: all foreign capital inflows that are invested directly into a company's equity; portfolio debt: all foreign capital inflows that are invested directly into a company's bonds. Other investment inflows: foreign capital inflows that are invested in other financial products.
NOTE: Numbers may not sum due to rounding.

SOURCE: MGI Capital Flows database; IMF Balance of Payments database; World Bank Development Indicators; McKinsey Global Institute analysis

THE GROWTH TRAJECTORIES OF AFRICA'S ECONOMIES HAVE DIVERGED

The average GDP growth figures for Africa disguise a clear divergence among the region's constituent economies since 2010. In the first decade of this century, growth accelerated in nearly every African country, but growth paths have clearly diverged over the past five years.

Since 2010, around half of Africa's 30 largest economies have experienced decelerating growth, while the other half have continued to accelerate. The decelerating economies include the continent's six largest—in order of size of GDP, Nigeria, Egypt, South Africa, Algeria, Morocco, and Angola. The countries experiencing accelerating growth include Botswana, Cameroon, Côte d'Ivoire, Democratic Republic of Congo, Ethiopia, Gabon, Ghana, Kenya, Madagascar, Namibia, Senegal, Tanzania, and Zimbabwe.

Two groups of countries experienced a sharp slowdown: countries affected by the political turmoil of the Arab Spring democracy movement, and Africa's oil exporters. The Arab Spring—triggered by the protest of an unemployed youth in Tunisia in late 2010—unleashed a wave of upheaval and conflict that soon spread to Libya and Egypt.[30] These three countries' economies did not grow at all between 2010 and 2015, a sharp contrast with 2000 to 2010, when they expanded at an average annual rate of 4.8 percent. Among oil exporters Algeria, Angola, Nigeria, and Sudan, the rate of growth fell sharply, from 7.3 percent to 4.0 percent (Exhibit 5). Productivity growth also declined in these two sets of economies—from 1.1 percent to 0.3 percent in the Arab Spring countries, and from 3.9 percent to 1.4 percent among Africa's oil-exporting economies.

In the rest of Africa, however, real annual GDP growth accelerated from 4.1 percent in the period from 2000 to 2010 to 4.4 percent between 2010 and 2015. Productivity grew at a consistent compound annual rate of 1.3 percent in both periods.

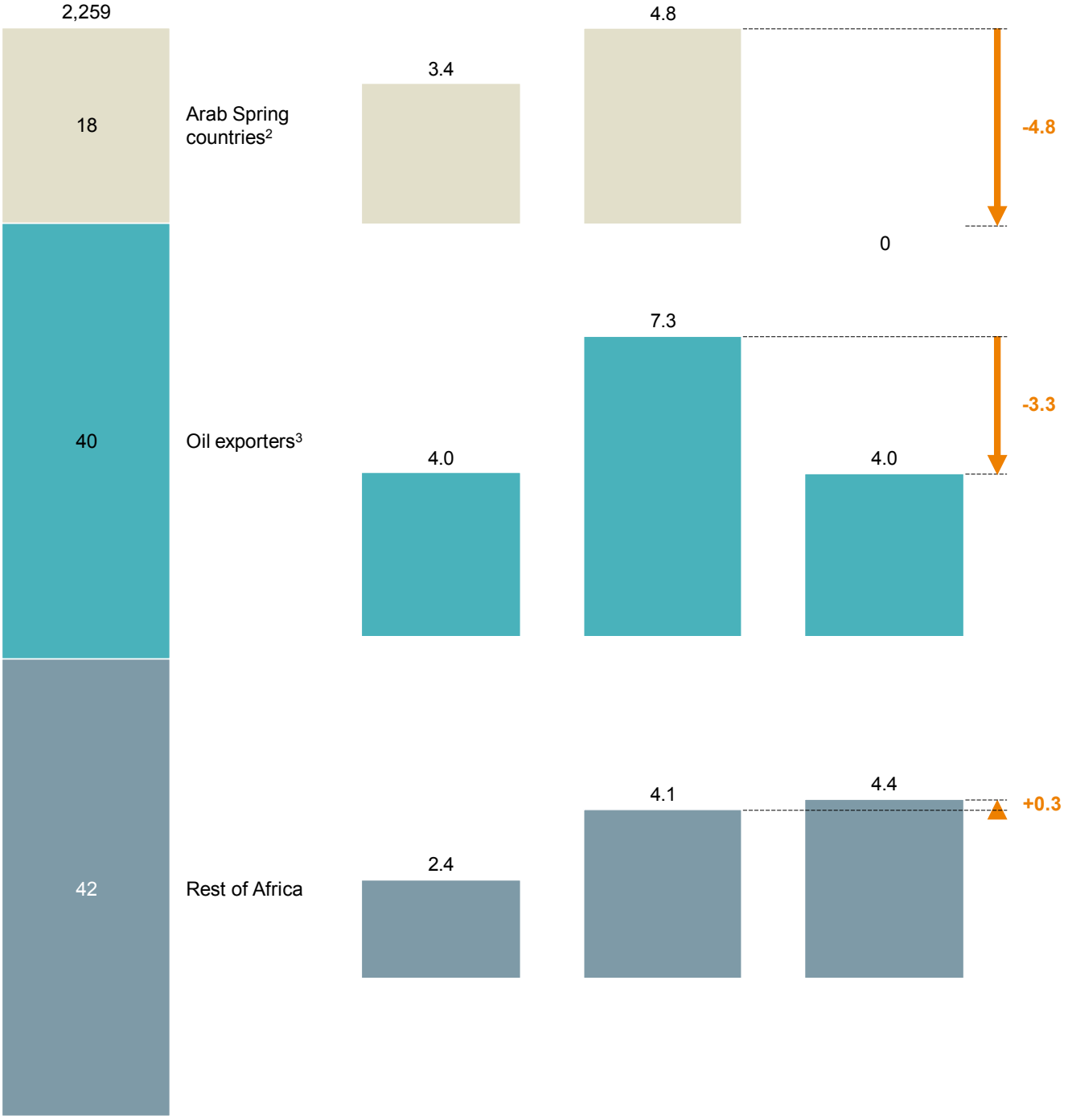
Growth has diverged among sectors, too. Resources accounted for 12 percent of African GDP growth between 2000 and 2010, but contributed a negative 4 percent to growth between 2010 and 2014 as commodity prices fell. However, industrial sectors increased their share of GDP growth from 17 percent to 23 percent, and the share of services rose from 44 percent to 47 percent (Exhibit 6). These shifts in the sector mix were observed in most countries in the region. In 85 percent of countries analyzed, the service sector, along with government and social services, grew faster than GDP, while resources typically contracted. The industry sector grew faster than GDP in about half of the countries examined.

[30] Combined with Islamist insurgencies in Nigeria, East Africa, and elsewhere, this drove a sharp increase in violence. The Uppsala Conflict Data Program, which monitors incidents of violence, found that in each year between 2010 and 2014 Africa experienced an average of nearly 1,500 incidents leading to at least one death—a 50 percent increase from the period between 2000 and 2010.

Exhibit 5

A sharp growth slowdown in Africa's oil exporters and countries involved in the Arab Spring dragged down the region's average GDP growth

	1990–2000	2000–10	2010–15
Total African GDP growth rate %	3.1	5.4	3.3



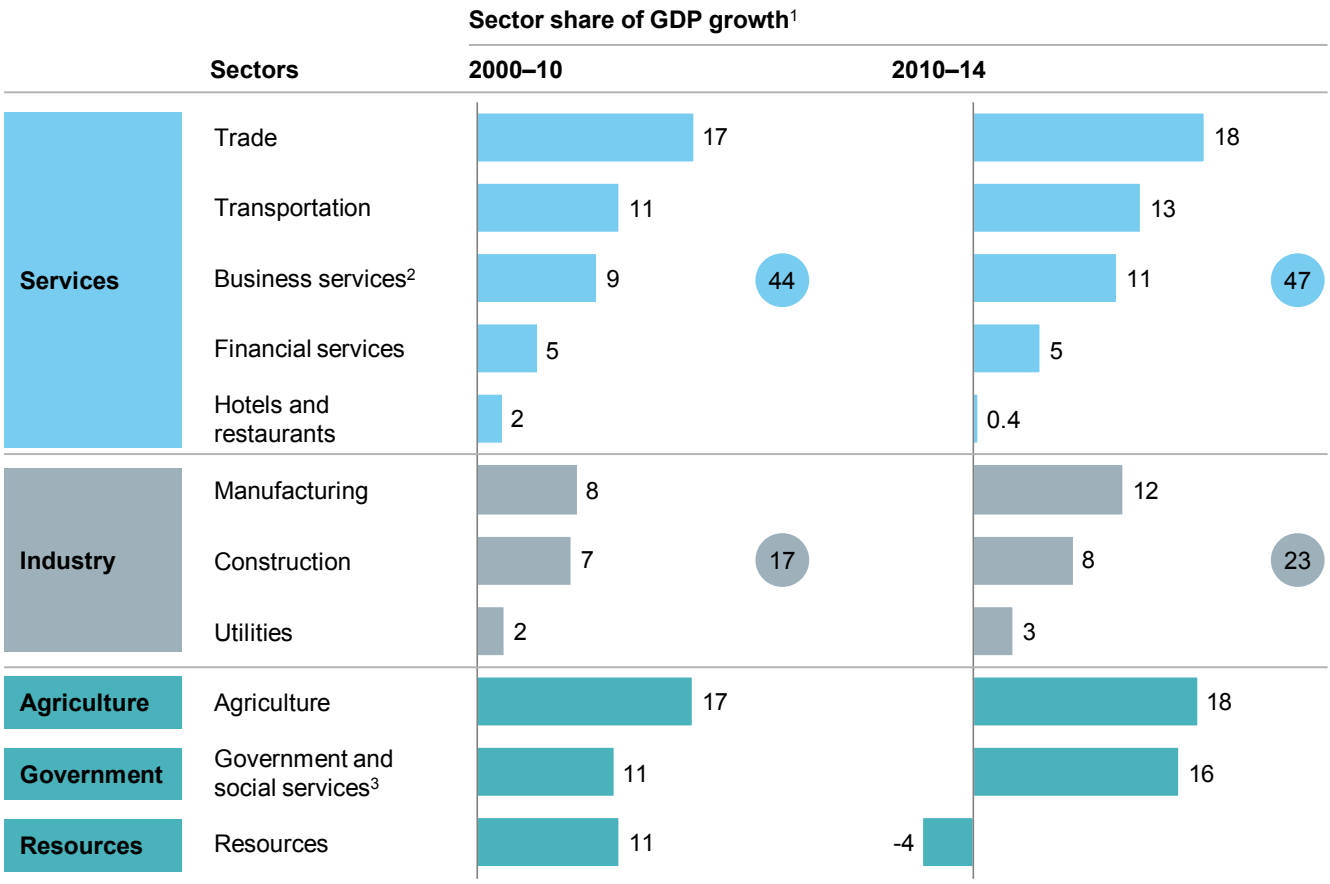
1 Includes GDP data for 53 African countries, excluding South Sudan.
2 Egypt, Libya, and Tunisia.
3 Algeria, Angola, Chad, Democratic Republic of Congo, Equatorial Guinea, Gabon, Nigeria, and Sudan.
NOTE: Numbers may not sum due to rounding.

SOURCE: *World economic outlook: Too slow for too long,* IMF, April 2016; McKinsey Global Institute analysis

Exhibit 6

The resources sector's share of GDP has declined, while the services and industrial sectors have generated a larger share of growth

%



1 Based on13 countries accounting for 80% of GDP: Algeria, Angola, Cameroon, Egypt, Ethiopia, Ghana, Kenya, Morocco, Nigeria, Senegal, South Africa, Tanzania, and Tunisia.
2 Includes real estate services.
3 Includes public administration, education, health, social, and private and household services.

SOURCE: *World economic outlook: Too slow for too long,* IMF, April 2016; United Nations Statistics Division; national statistical offices; *Ethiopia's great run: The growth acceleration and how to pace it*, Lars Christian Moller, World Bank, working paper number 99399, November 2015; McKinsey Global Institute analysis

MGI'S NEW AFRICAN STABILITY INDEX GAUGES THE DEGREE OF RESILIENCE TO SHOCKS OF INDIVIDUAL AFRICAN ECONOMIES

The recent divergence in the growth performance of Africa's economies is a reminder that this is a diverse region and that many of its countries remain vulnerable to economic, social, and political shocks. To better gauge the resilience of each country, MGI has developed an African Stability Index. Our hope is that this index can be a useful tool that helps businesses and investors to balance their portfolios and helps policy makers to understand and then address their country's vulnerabilities.

The index measures three stability factors that have equal weighting. The first is the country's macroeconomic stability, which reflects its gross debt-to-GDP ratio and its external balances measured by reserves in months of imports. The second is economic diversification measured by resources as a share of exports. The third is social and political stability, which includes unemployment levels, the Ibrahim Index of African Governance, and the number of incidents of violence as measured by the Uppsala Conflict Data Program. Each country's stability ranking is then plotted against its compound annual GDP growth rate between 2010 and 2015 (Exhibit 7). This retrospective analysis helps us to discern the

challenges that countries need to address if they are to strengthen their resilience in the face of shocks and build a platform for future growth (see the appendix for a full table showing how Africa's 30 largest economies perform on the index).[31]

This analysis shows that some countries have been significantly more resilient than others in the face of pressures on growth, and economic and political shocks. Three distinct groups emerge.

- **Stable growers.** These countries, which accounted for 19 percent of Africa's GDP in 2015, posted average GDP growth of 5.8 percent a year between 2010 and 2015—higher than the 2.9 percent a year global average over this period—and demonstrated relatively high levels of stability. Countries in this group include Botswana, Côte d'Ivoire, Ethiopia, Kenya, Mauritius, Morocco, Rwanda, Senegal, Tanzania, and Uganda. These economies are typically not dependent on resources for growth, are of relatively small size, and are progressing with economic reforms and increasing their competitiveness. Five of the stable growers are in East Africa, reflecting that region's relative immunity to resource shocks and its relatively high levels of political stability. For investors and businesses considering their African portfolios and expansion strategies, this group of countries offers a range of opportunities including their consumer markets, manufacturing, and infrastructure development. Governments still need to work hard to sustain stability and growth and to ensure that their benefits are felt across society.

- **Vulnerable growers.** These countries, which accounted for 35 percent of African GDP in 2015, achieved average GDP growth of 5.1 percent a year over the past five years but had relatively low levels of stability. They each had at least one of three types of vulnerability. Some, such as Angola, Nigeria, and Zambia, are heavily dependent on resource exports, and have therefore had a diversification challenge. Others, such as Democratic Republic of Congo, face security or governance challenges. Finally, a number of these countries, such as Ghana and Mozambique, are vulnerable to macroeconomic difficulties. For investors, vulnerable growers still offer promising growth potential, but they also pose risks that need to be properly assessed and understood (see the appendix for details of the underlying drivers of each country's relative stability).[32] For governments, several long-term initiatives can improve stability, including mobilizing domestic resources to diversify sources of investment and state funding, continued economic diversification, and further strengthening infrastructure (see Chapter 5 for further discussion).[33]

- **Slow growers.** These countries, which accounted for 46 percent of Africa's GDP in 2015, together grew at 1.3 percent per year between 2010 and 2015—less than the 2.9 percent a year global average over that period—and have had varying degrees of stability. This group includes the countries affected by the Arab Spring—Libya, Egypt, and Tunisia. It also includes South Africa, whose growth has lagged behind the rest of sub-Saharan Africa in recent years (although recent MGI research found that it has considerable growth potential in agri-processing, service exports, and manufacturing).[34] Given the scale of several of these economies, investors will need to assess growth opportunities at the sector level or use their activities in these slow growers as a base from which to expand into other parts of the region.

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31 The appendix for this report is available online at www.mckinsey.com/mgi.

32 The appendix is available online at www.mckinsey.com/mgi.

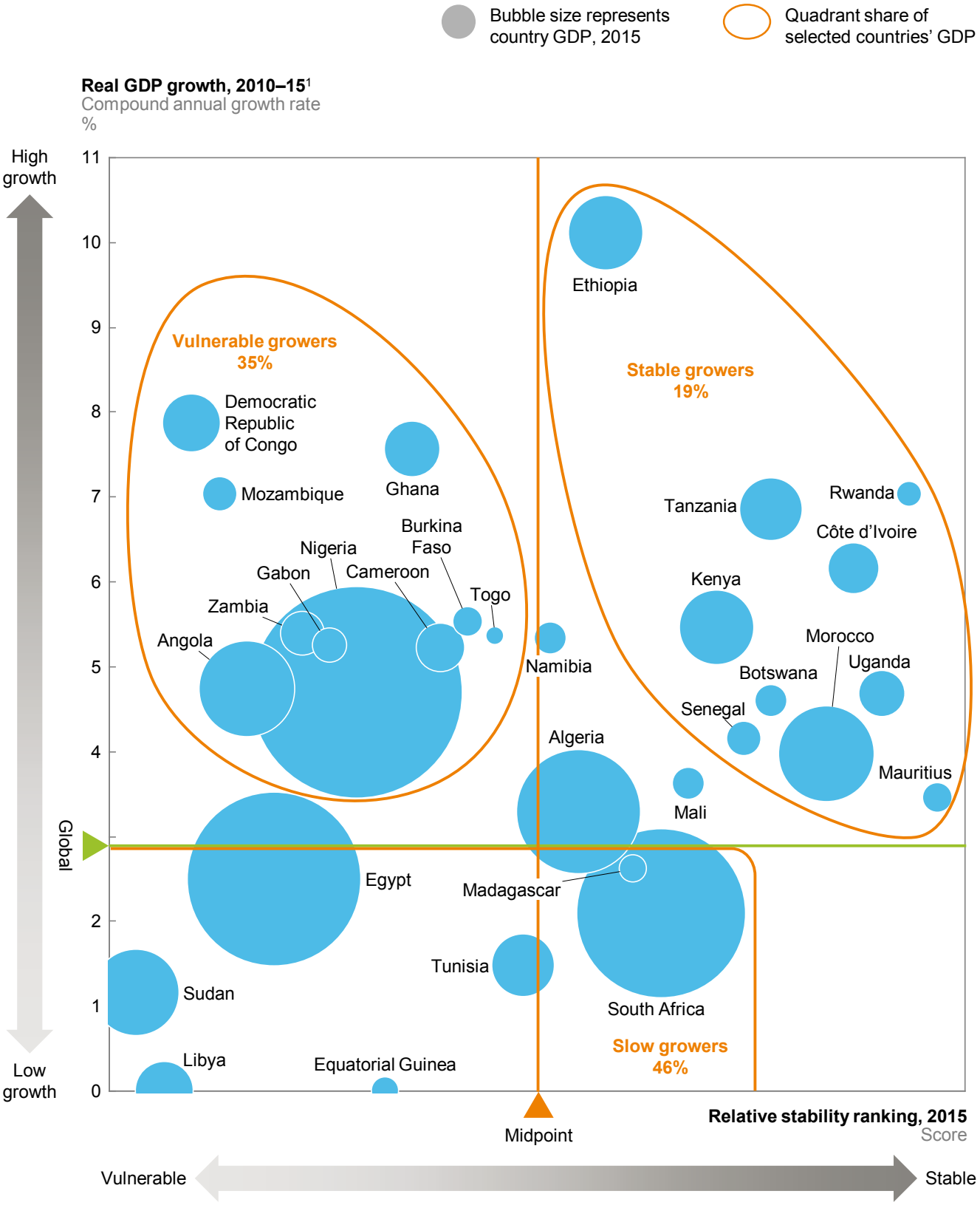
33 For discussion on the specific steps that Nigeria can take to drive sustained and inclusive growth, see *Nigeria's renewal: Delivering inclusive growth in Africa's largest economy*, McKinsey Global Institute, July 2014.

34 Recent MGI research found that South Africa has considerable potential to accelerate growth by focusing on key opportunities such as agri-processing, service exports, and manufacturing, in which it enjoys a comparative advantage. See *South Africa's big five: Bold priorities for inclusive growth*, McKinsey Global Institute, August 2015.

Exhibit 7

Some countries have weathered economic challenges better than others—three divergent groups emerge from MGI's African Stability Index

Comparison of historical GDP growth rates to country stability rankings



1 The index covers 30 economies accounting for 96% of GDP; Equatorial Guinea and Libya are plotted manually because of negative growth rates over this period.

SOURCE: *World economic outlook: Too slow for too long,* IMF, April 2016; McKinsey African Stability Index; McKinsey Global Institute analysis

FOUR POSITIVE LONG-TERM FACTORS ARE LIKELY TO ENSURE THAT AFRICA'S ECONOMIES ACCELERATE THEIR GROWTH OVER THE NEXT FIVE YEARS

Although, as we have discussed, the growth paths of individual African economies have diverged over the past five years, overall the region's GDP is still expanding faster than the world average and is forecast to accelerate over the next five years to once again make Africa the world's second-fastest growing region. Behind this positive outlook lie four positive long-term factors.

Africa has the most rapid urbanization of any region in the world

Africa has the advantage of being at a relatively early stage of its urbanization—which means that many of the associated economic benefits still lie ahead. In 1975, only 25 percent of Africans lived in cities; by 2015 that share had risen to 40 percent. Around 2037, Africa will make a historic shift from a majority-rural to a majority-urban continent. By 2045 a projected 54 percent of its people will live in cities.[35]

Africa's urbanization is happening rapidly and on a large scale. The continent will soon be by far the fastest urbanizing region in the world. Between 2015 and 2045, the population of urban Africa is expected to increase by an average of 24 million people each year, compared with 11 million a year in India and nine million a year in China (both of these countries began urbanizing earlier than Africa) (Exhibit 8). Urbanization in most Western countries has already largely run its course. In the United States, Western Europe, and Latin America, around 80 percent of the population already lives in urban areas.[36]

Africa's growing labor force makes the continent unusual in a broadly aging world.

Over the next decade alone, an additional 187 million Africans will live in cities—equivalent to ten cities the size of Cairo, the continent's largest metropolitan area. The number of African cities with five million or more inhabitants will more than double from six to 15, and the number of cities with more than one million inhabitants will increase from 66 to nearly 100.[37]

Urbanization has a strong correlation with the rate of real GDP growth, because productivity in cities is more than twice as high as it is in the countryside. Africa's urban per capita GDP was $8,200 in 2015, compared with $3,300 in rural areas. Higher productivity leads to higher incomes, and densely populated cities offer better infrastructure and services such as education, and large consumer markets for businesses. To capture the economic benefits of urbanization, governments and companies will need to work together to ensure that infrastructure and services are sufficient to meet the needs of the expanding population—and to avoid some of the stresses on urban society of unmanaged growth, including a lack of affordable housing, traffic congestion (which compromises productivity), and pollution (see Chapter 5 for a discussion of the main components of an effective urban agenda).[38]

[35] United Nations Population Division database.

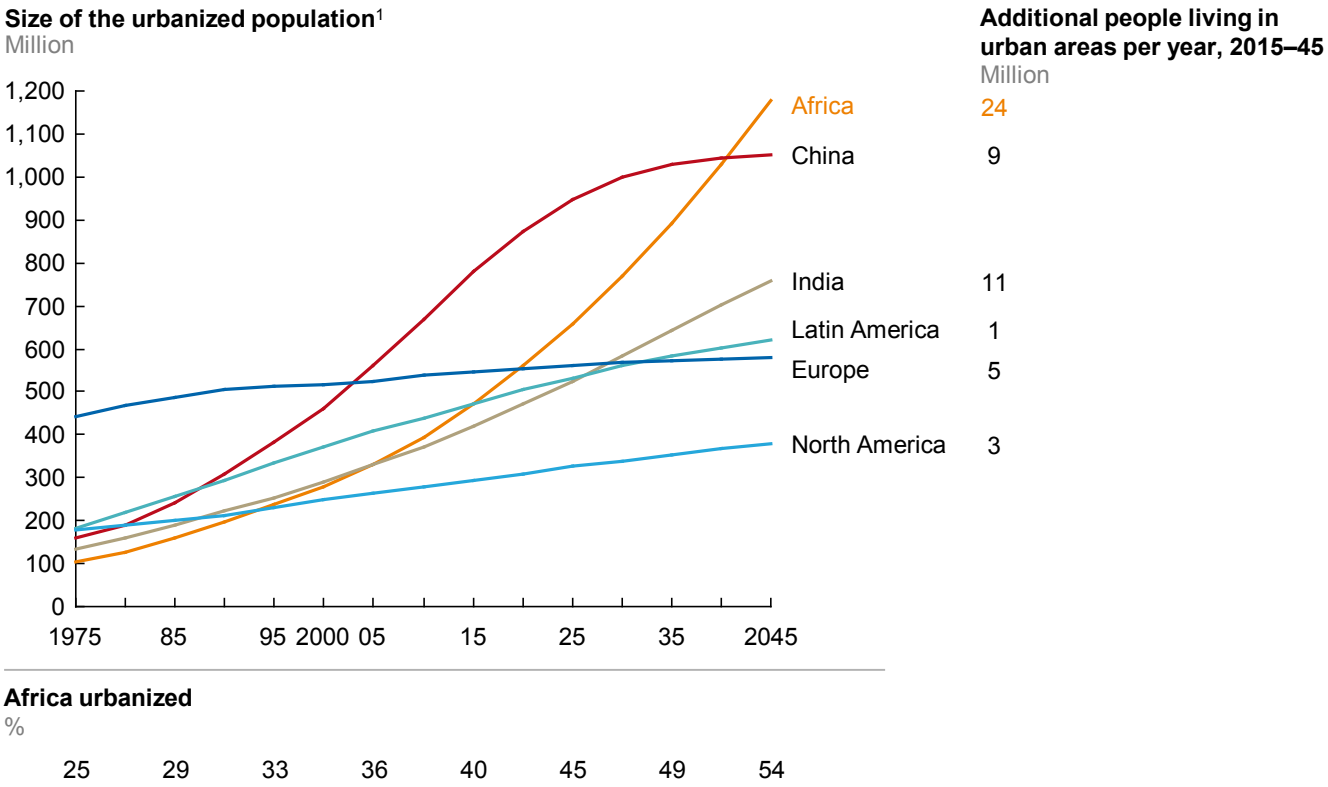
[36] *Urban world: The global consumers to watch*, McKinsey Global Institute, March 2016.

[37] McKinsey Global Institute Cityscope, 2015.

[38] In Latin America, the top ten cities have experienced slower GDP growth than middle-sized cities over the past 20 years, which appears to reflect diseconomies of scale due to stresses such as congestion, slum living, and a deteriorating quality of life. For more discussion on this point, see *Building globally competitive cities: The key to Latin American growth*, McKinsey Global Institute, August 2011.

Exhibit 8

Africa is urbanizing faster than any other region; its cities are expected to gain 24 million people each year until 2045



1 Population living in urban areas. UN forecasts last adjusted in 2014.

SOURCE: World urbanization prospects, June 2014 revision, United Nations population division; McKinsey Global Institute analysis

By 2034, Africa's workforce will be larger than that of either China or India

Africa has a young population and a growing labor force—a highly valuable asset in an aging world. Between 2010 and 2015, Africa's working-age population increased by 14 percentage points compared with nine percentage points in India and only one percentage point in China (Exhibit 9).[39] In 2034, the continent is expected to have a larger working-age population than China or India, at 1.1 billion people.

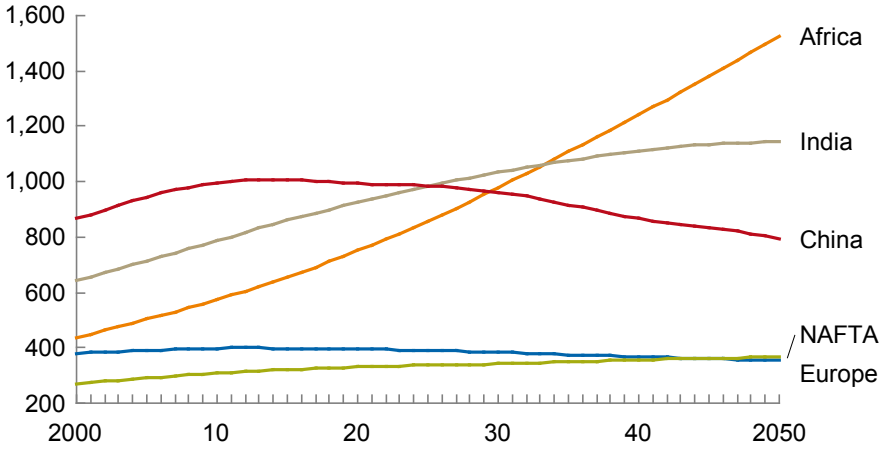
Africa's growing labor force makes the continent unusual in a broadly aging world. About 60 percent of the world's population lives in countries with fertility rates below replacement rates. For the first time in human history, demographic change could mean that the planet's population plateaus. In some countries, one-third of the workforce could retire in the next decade, with a potentially negative impact on economic growth prospects. But Africa's demographics are still working in its economic favor. An expanding working-age population is associated with strong rates of GDP growth and offers a potential demographic dividend. Unlike most other regions, Africa's dependency ratio—the number of retirees and children as a proportion of the total population—is declining.

[39] Partly as a result of its one-child policy, China experienced a sharp decline in the fertility rate from about 5.8 births per woman in 1964 to 1.6 in 2012, and it reached a peak share of the working-age population in 2010. India's fertility rate has declined much more gradually, from 5.8 births per woman in 1964 to 2.5 in 2012. India's share of the working-age population is not expected to peak until 2051. See *Global growth: Can productivity save the day in an aging world?* McKinsey Global Institute, January 2015.

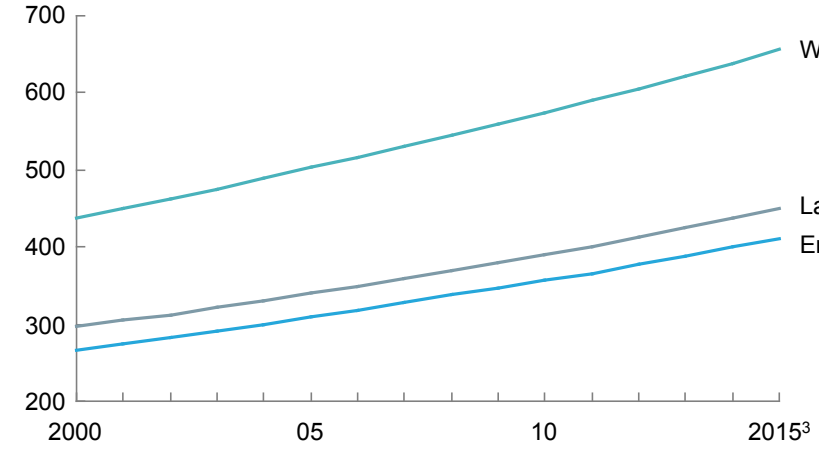
Exhibit 9

Africa is set to have a larger working-age population than either China or India by 2034; employment is also picking up

Working-age population in largest countries and regions[1]
Million people aged 15–64



Working-age population employment status breakdown
Million adults



Compound annual growth rate, 2000–15
%

Working-age population	2.7
Labor-force population	2.8
Employment[2]	2.9

1 Working-age population = individuals aged 15–64.
2 Includes vulnerable employment and stable employment.
3 International Labor Organisation (ILO) estimates.

SOURCE: IHS; ILO; McKinsey Global Institute analysis

An expanding workforce has many potential economic benefits but poses challenges, too, not least ensuring that the continent's economies create sufficient jobs for the many millions of young people entering the workforce (and ensuring that they have the skills to perform those jobs). Africa has recently had some success in creating jobs. An estimated 21 million new stable (formal, wage-paying) jobs have been created over the past five years, and 53 million over the past 15 years. Stable jobs grew at a rate of 3.8 percent between 2000 and 2015, faster than growth in the labor force of 2.8 percent. These figures probably provide a better indication of the continent's jobs performance than its overall employment figures do, as considerable doubt surrounds unemployment data in Africa. That said, Africa's official unemployment rate stood at 8.4 percent in 2015, down from 10 percent in 2010. This is progress, but the job creation trajectory will need to be raised significantly to fuel future growth.[40]

[40] See *Africa at work: Job creation and inclusive growth*, McKinsey Global Institute, August 2012.

Skills, as we have noted, are another major challenge (see Chapter 5 for further discussion). The average time African children spend in school increased from 3.2 years in 2000 to 5.3 years in 2010, but the rate of improvement has subsequently slowed.[41] To put this into context, children in other emerging regions spend an average of 7.5 to eight years in school. Sub-Saharan Africa's student-teacher ratio in primary schools was 40 students per teacher in 2013, almost twice that in other regions.[42]

Technological advances create new opportunities for growth

Technological change is transforming virtually every economy around the world.[43] McKinsey and MGI research has shown that access to the internet is a powerful driver of growth and productivity growth.[44] The impact could be greater in Africa than in any other region because the continent is in the relatively early stages of adoption of the internet, digital technologies that offer fast processing power and unprecedented connectivity, and big data that is leading to new business models and improving business operations.[45] Our previous research showed that if Africa's businesses and governments harness the full economic potential of the internet, it could add $300 billion to the continent's GDP by 2025.[46]

Sub-Saharan Africa had by far the fastest rate of new broadband connections between 2008 and 2015 at 34 percent per year.[47] Broadband penetration in this part of Africa is expected to increase from 20 percent in 2015 to 80 percent by 2020.[48] Electronic payments are sweeping across the region and changing the business landscape as a result; East Africa is already a global leader in mobile payments. Africa's penetration of smartphones is expected to hit at least the 50 percent mark in 2020, up from only 18 percent in 2015.[49] E-commerce in Africa is growing quickly. Nigeria has experienced a doubling of revenue each year since 2010, while the more established industry in South Africa grew revenue by 28 percent year on year over the same period.[50]

In sub-Saharan Africa, cellular-enabled machine-to-machine connections are expected to grow by around 25 percent per year to 30 million by 2020.[51] In many sectors, this is changing the game. In health care, for instance, mobile application technology is finding its way into South African city ambulance services to ensure that the closest ambulance to the scene is dispatched, which together with optimized traffic routing is greatly improving response times. The solution allows test results from remote laboratories to reach clinics faster, saving

41 UNDP International Human Development Indicators. Also see Robert J. Barro and Jong-Wha Lee, "A new data set of educational attainment in the world, 1950–2010," *Journal of Development Economics*, volume 104, issue C, 2013; UNESCO Institute for Statistics, 2013; and Human Development Report Office estimates based on data on educational attainment from UNESCO Institute for Statistics, 2013.

42 World Bank World Development Indicators database.

43 See Richard Dobbs, James Manyika, and Jonathan Woetzel, *No ordinary disruption: The four forces breaking all the trends*, PublicAffairs, 2015

44 A 2011 analysis of the economic impact of the internet in 13 economies accounting for more than 70 percent of global GDP (the G8, the BRIC countries of Brazil, Russian, India, and China, plus Sweden and South Korea), found that the internet had generated 21 percent of GDP growth over the previous five years. A subsequent 2012 report on 30 "aspiring countries" defined as having the economic size and dynamism to be significant players on the global stage—including Malaysia, Taiwan, and Vietnam—found that internet penetration had increased at 25 percent a year over the previous five years. The research found that the internet on average generated 1.9 percent of GDP in these aspiring economies, still far below the average 3.4 percent share in developed economies. See *Internet matters: The Net's sweeping impact on jobs, growth, and prosperity*, McKinsey Global Institute, May 2011, and *Online and upcoming: The internet's impact on aspiring countries*, McKinsey High Tech Practice, January 2012.

45 MGI has published extensively on the power of digital technologies to transform businesses. See, for instance, two recent reports: *Digital America: A tale of the haves and have-mores*, McKinsey Global Institute, December 2015, and *Digital Europe: Pushing the frontier, capturing the benefits*, McKinsey Global Institute, June 2016.

46 *Lions go digital: The internet's transformative potential in Africa*, McKinsey Global Institute, November 2013.

47 Analysys Mason DataHub.

48 Ovum Ltd.

49 Estimated by MGI based on forecasts from GSMA, *Sub-Saharan Africa mobile economy report 2013*, and GSMA, The mobile economy: Sub-Saharan Africa 2015, and UN Population Division.

50 Euromonitor International, 2016, from trade sources and national statistics.

51 GSMA, *The mobile economy: Sub-Saharan Africa 2015*.

lives in the process. In the power sector, South Africa-based mobile telecommunications company MTN Group recently implemented a smart metering project in Johannesburg with the aim of installing 50,000 meters in the first phase of the project.[52] In education, the African Leadership University, which launched in Mauritius in 2015, uses technology to reduce teaching costs and deliver innovative e-learning modules; its intention is to use this platform to build 25 campuses across Africa.[53] We are also beginning to see examples of technology being used in certain forms of distributed infrastructure such as smaller-scale solar energy solutions for households.

Africa continues to have rich reserves of resources

Although commodity prices are low, another great long-term strength for Africa—particularly when demand, and eventually, investment, recover—is the fact that the continent still has very significant resources. Africa contains 60 percent of the world's unutilized but potentially available cropland, and the world's largest reserves of vanadium, diamonds, manganese, phosphate, platinum-group metals, cobalt, aluminum, chromium, and gold. Moreover, only a fraction of Africa's subsoil assets has been discovered—as little as one-fifth the level of OECD countries, by some estimates.[54] The continent is responsible for 10 percent of global exports of oil and gas, 9 percent of copper, and 5 percent of iron ore—and even at recent lows in the prices of these resources, a significant share of African production continues to be in a competitive cost position.[55] To ensure that Africa makes the most of its endowments of natural resources, governments will need to ensure that exploration and investment in the sector are more attractive, even in a weaker environment. For their part, companies need to review their approach to community engagement, so that they have the support of local communities as well as their "license to operate" from regulators.[56]

•••

Several of Africa's largest economies, particularly countries in North Africa and the continent's oil exporters, have had to deal with significant economic and political shocks over the past five years, and major challenges lie ahead. This has led to diverging growth trajectories among African economies, and continuing challenges in 2016. We still see substantial potential to accelerate growth across the continent because long-term fundamentals remain strong. However, there is little doubt that achieving Africa's full potential will require proactive efforts from governments in conjunction with business. Hard work is needed in a number of areas to ensure that Africa benefits from its positive demographics and its continuing rapid urbanization. Appropriate initiatives need to be put in place to tap the benefits of digitization and to make the most of Africa's large reserves of natural resources. In the next chapter, we turn to a discussion of the opportunities that can be captured from rising spending by both consumers and businesses.

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52 GSMA, *The mobile economy: Sub-Saharan Africa 2014*.

53 Alueducation.com.

54 Paul Collier, *The plundered planet: How to reconcile prosperity with nature*, Allen Lane, 2010.

55 United Nations Comtrade database. Africa's competitive cost position is based on the oil and gas cost curve from McKinsey Energy Insights, January 2016; copper, gold, and iron ore cost curves developed by the McKinsey Basic Materials Practice using data from Wood Mackenzie, *Financial Times*, McKinsey's proprietary MineSpans Commodity Insights, the World Bank, and internal proprietary models.

56 For further discussion, see *Reverse the curse: Maximizing the potential of resource-driven economies*, McKinsey Global Institute, December 2013.

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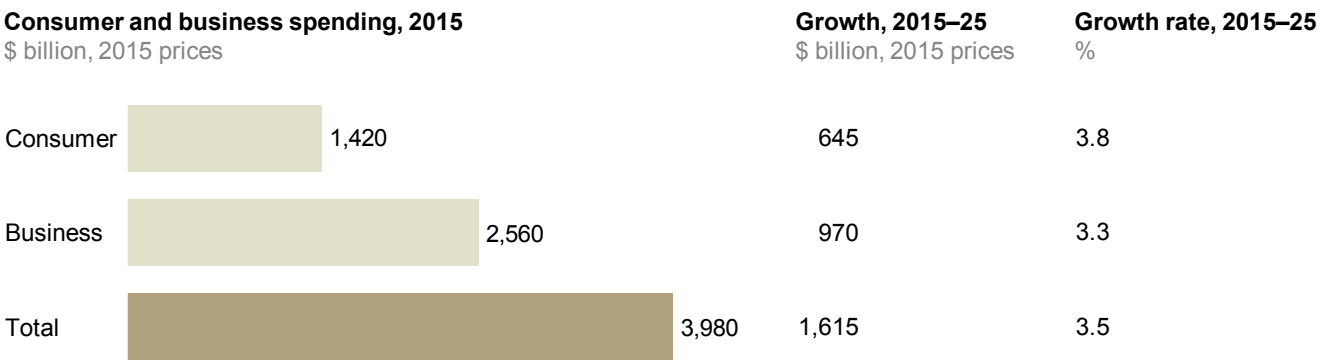
2. SERVING AFRICA'S MARKETS: A $5.6 TRILLION OPPORTUNITY

Although Africa's economic slowdown has put many households under stress, overall private consumption has grown faster than the continent's GDP over the past five years, to reach $1.4 trillion in 2015. We project that Africa's households will spend $2.1 trillion by 2025, offering promising business opportunities in a range of consumer-facing industries, from housing to health care to leisure. Companies in Africa offer an even larger market, one whose spending will grow to a projected $3.5 trillion by 2025. This B2B market is made up of thousands of firms, most of them smaller businesses, across a wide range of sectors.[57] Among them, they have substantial and fast-growing demand for materials, capital goods, and services.

Together, these two sources of spending totaled around $4 trillion in 2015 and are expected to increase spending to a combined $5.6 trillion in 2025 (Exhibit 10).[58]

Exhibit 10

Consumer and business spending in Africa represents a $4 trillion opportunity



SOURCE: Oxford Economics; IHS; McKinsey Global Institute analysis

$5.6T
consumer and business spending expected in 2025

AFRICA'S PRIVATE CONSUMPTION IS PROJECTED TO GROW TO $2.1 TRILLION BY 2025

In the first decade of this century, Africa's household consumption grew rapidly, at 5.8 percent a year between 2000 and 2005, and 5.2 percent a year from 2005 to 2010. However, between 2010 and 2015, the rate of growth fell to 3.9 percent, reflecting the continent's economic slowdown. Nonetheless, Africa's private consumption was the fastest growing of any region except emerging Asia, and it outstripped that of Central and Eastern Europe, which grew at 2.3 percent a year between 2010 and 2015, and Latin America's 2.5 percent growth. Africa's overall consumer spending totaled $1.4 trillion in 2015. This was significantly higher than that of India or Brazil, and more than double consumer spending in Russia.

[57] In this report we define large companies as those earning $500 million or more in revenue each year.

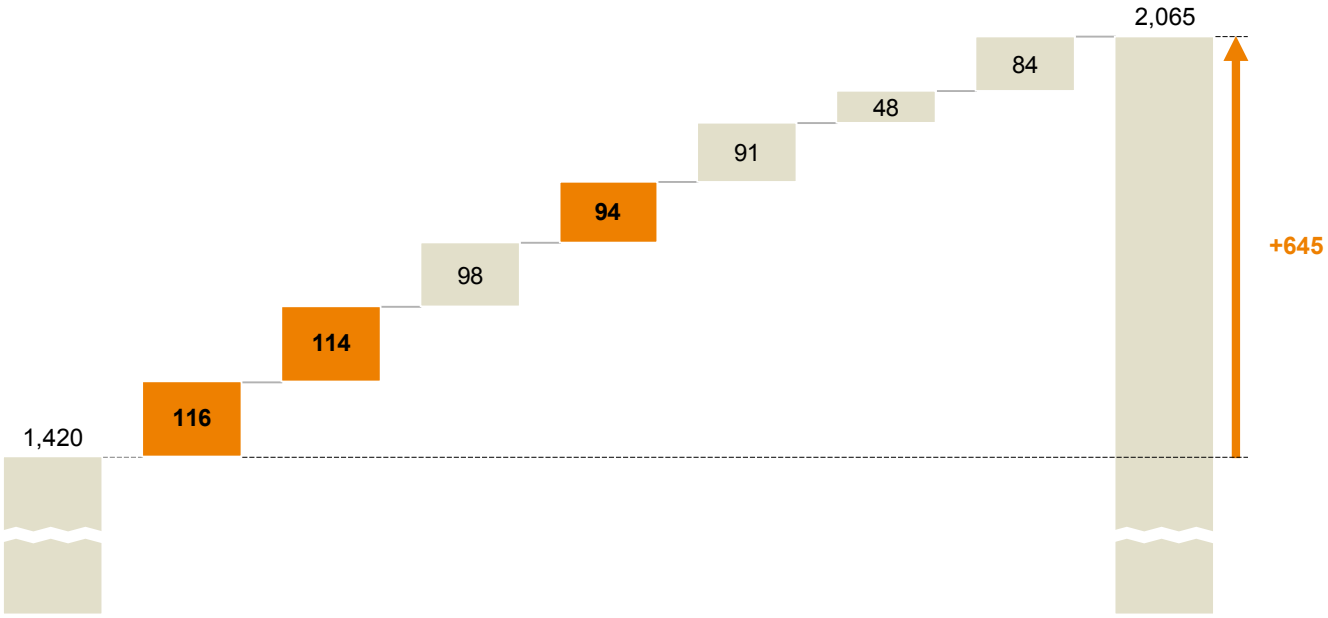
[58] Africa's GDP was estimated at $2.2 trillion in 2015. This should not be confused with consumer and business spending that totals an estimated $4 trillion.

We expect that Africa's private consumption will grow at an impressive rate of 3.8 percent to nearly $2.1 trillion in 2025 in real 2015 prices. Half of that additional consumption is forecast to come from East Africa, Egypt, and Nigeria (Exhibit 11).

Exhibit 11

Africa's household consumption is set to grow by $645 billion by 2025 with half coming from East Africa, Egypt, and Nigeria

Country contribution to growth in household consumption 2015–25[1]
$ billion, 2015 prices



	Consumption, 2015	East Africa	Egypt	Rest of North Africa	Nigeria	Franco-phone Africa[2]	South Africa	Rest of SSA[3]	Consumption, 2025
Share of consumption growth, 2015–25 %		18	18	15	15	14	7	13	

1 Breakdown is representative of 39 countries in Africa.
2 Includes 15 countries in Central and West Africa; excludes North Africa and East Africa.
3 Sub-Saharan Africa.
NOTE: Numbers may not sum due to rounding.

SOURCE: Oxford Economics; IHS; McKinsey Global Institute analysis

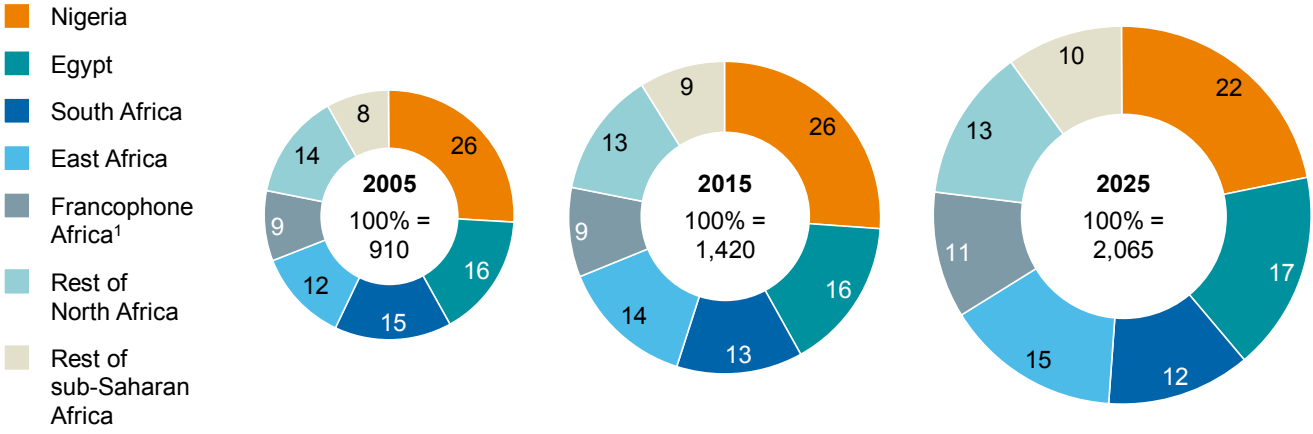
Half of additional private consumption in the period to 2025 is set to come from East Africa, Egypt, and Nigeria.

While demand is increasing across the continent, it is growing significantly faster in some parts of the region than in others. East Africa and Francophone Central and West Africa will increase their share of consumption, as will Egypt, the continent's second largest market. East Africa's share of African's overall consumption is expected to increase from 12 percent in 2005 to 15 percent in 2025, and that of Francophone Africa from 9 percent to 11 percent. Although Nigeria will remain the largest consumer market, its share of Africa's household spend is expected to fall from 26 percent in 2015 to 22 percent in 2025; South Africa's is set to decline, too (Exhibit 12).

Exhibit 12

The regional share of household consumption is projected to grow by $645 billion by 2025

Total household consumption, 2005–25
%; $ billion, 2015 prices



1 Includes 15 countries in Central and West Africa; excludes North Africa and East Africa.
NOTE: Numbers may not sum due to rounding.

SOURCE: Oxford Economics: IHS; African Development Bank; McKinsey Global Institute analysis

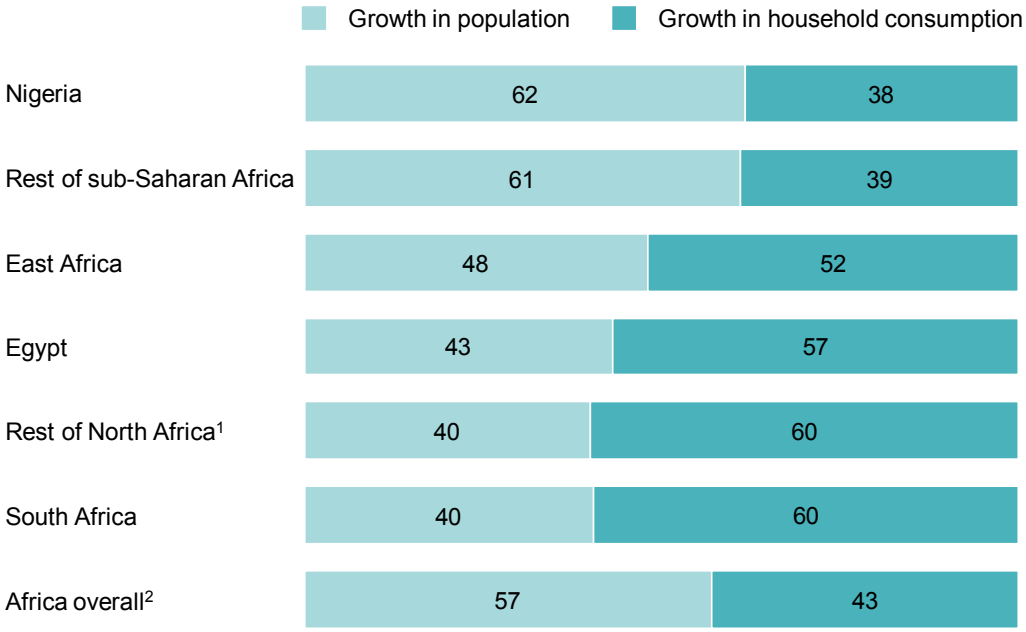
Discretionary spending is growing in importance

In Africa as a whole, around 60 percent of new household spending over the past decade has been due to population growth, with the rest driven by higher incomes. These shares are expected to remain constant over the decade ahead. However, the role of rising household income is considerably more pronounced in some parts of the region. Since 2005, rising incomes have driven 52 percent of consumption growth in East Africa, 60 percent in South Africa, 57 percent in Egypt, and 60 percent in the rest of North Africa (Exhibit 13).

Exhibit 13

The drivers of consumption growth vary among countries

Breakdown of contribution to consumption growth, 2005–15[1]
%, 2015 prices



1 Includes Algeria, Libya, Morocco, and Tunisia.
2 Representative of 39 countries in Africa.
NOTE: Numbers may not sum due to rounding.

SOURCE: Oxford Economics; Canback Global Income Distribution Database (C-GIDD); IHS; McKinsey Global Institute analysis

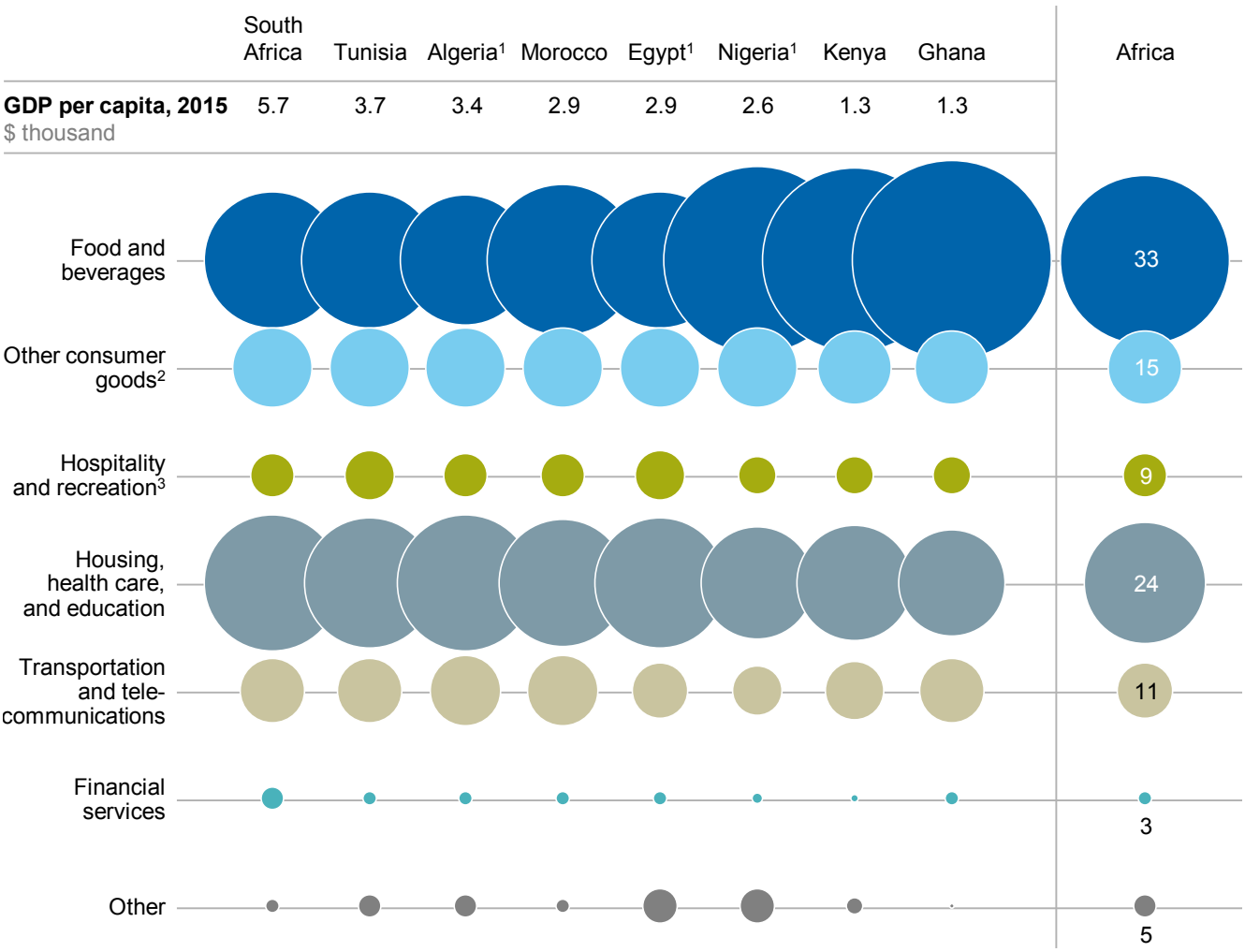
These trends have important implications for the kinds of goods and services that African consumers are purchasing. Food and beverages still constitutes the single largest consumption item, accounting for as much as one-third of Africa's household spending in 2015. But discretionary categories already make up a substantial share of consumption, and they are growing more quickly than categories characterized as basic necessities. Spending on services including housing, health care, and education accounted for 24 percent of household expenditure in 2015, and consumer goods such as clothing, motor vehicles, and household goods accounted for 15 percent. Other major categories, including transportation and telecommunications, and hospitality and recreation, each accounted for around 10 percent of household consumption (Exhibit 14).

In higher-income countries such as South Africa and the North African nations, spending on housing, health care, and education equals spending on food and beverages, and spending on consumer goods, transportation, and telecommunications is higher than in the rest of Africa. By contrast, in lower-income countries including Ghana, Kenya, and Nigeria, close to 40 percent of household spending in 2015 was devoted to food and beverages.

Exhibit 14

Spend patterns vary relative to consumer wealth, particularly the share of spend on basics (food and beverages)

Proportion of consumption expenditure by category, 2015
%



1 Based on non-oil GDP.
2 Includes clothing, household goods, and automotive.
3 Includes spending on leisure, hotels, and catering.

SOURCE: Euromonitor Passport; Canback Global Income Distribution Database (C-GIDD); IHS; McKinsey Global Institute analysis

The shift to discretionary consumption is reflected in the growth rates of sales of particular product categories. While bread and cereals sales increased at an annual rate of 3.3 percent between 2005 and 2015 across Africa, sales of medical products grew at 10.2 percent a year, telecommunications services by 6.6 percent, and transportation services at 5.8 percent. Other categories that grew quickly included utilities, financial services, and motor vehicles. The effect of rising incomes was also reflected in the food and beverages category; sales of discretionary items, such as soft drinks, alcoholic beverages, and meat, all grew at around 5 percent a year. Again, the country-level picture differs according to income levels. For example, food and beverage sales grew faster than average in Cameroon and Kenya, while sales of medical products and motor vehicles grew fastest in Egypt and elsewhere in North Africa.

Overall, we expect these trends to continue to 2025. We estimate that Africa's food and beverages sector to grow at an annual rate of 3.1 percent over the next decade but expect significantly faster growth among discretionary categories. Financial services are expected to lead the pack with annual growth of 5.4 percent, followed by hospitality and recreation at 5.1 percent, and housing and health care at 4.4 percent and 4.3 percent, respectively (Exhibit 15).

Exhibit 15

Food will constitute the largest share of consumption growth in the period to 2025, but the fastest-growing categories include financial services, hospitality, housing, and health care

Category growth, 2015–25
$ billion, 2015 prices
(real compound annual growth rate, %)

Growth $ billion >$15 $5–15 <$5

Country	Food and beverages	Other consumer goods	Housing	Health care[1]	Financial services	Telecommunications	Hospitality and recreation	Other[2]	Overall growth
Nigeria	28.7	10.9	16.8	8.1	3.1	1.9	10.5	14.3	94 (2.3)
South Africa	9.5	7.6	8.7	3.0	3.0	1.1	8.8	6.3	48 (2.3)
Egypt	19.2	19.1	20.4	8.7	7.1	0.9	16.9	21.7	114 (4.1)
Algeria	4.4	4.4	4.7	1.9	1.3	0.1	4.2	5.2	26 (3.3)
Morocco	6.2	4.8	5.5	2.4	1.7	0.2	4.2	5.8	31 (4.2)
Sudan	6.3	2.9	4.0	1.9	1.8	0.5	2.5	2.8	23 (3.5)
Angola	14.5	5.6	6.7	3.1	~0.1	0.7	4.1	7.9	43 (5.9)
Kenya	9.1	4.9	5.8	2.7	1.1	0.8	3.8	5.8	34 (5.3)
Rest	69.0	32.5	38.3	17.4	7.7	6.2	24.5	36.5	232 (5.3)
Overall	167 (3.1)	93 (3.6)	111 (4.4)	49 (4.3)	27 (5.4)	12 (2.3)	80 (5.1)	106 (4.0)	645 (3.8)

1 Includes health services and medical products.
2 Other includes education and transportation.
NOTE: Numbers may not sum due to rounding.

SOURCE: McKinsey Global Banking Pools; Canback Global Income Distribution Database (C-GIDD); Euromonitor; WCIS; BMI; Ovum; Yankee; McKinsey Global Institute analysis

Rising household spending, together with a shift in consumption patterns, will create opportunities for companies in a range of sectors to build profitable businesses—as well as help millions of African households achieve a step-change improvement in their quality of life. These companies can target fast-growing categories in particular countries. For example, we expect the housing market will grow by $20 billion in Egypt and $17 billion in Nigeria over the next decade, and by at least $5 billion each in Angola, Kenya, Morocco, and South Africa. Demand for typically discretionary consumer goods is another huge opportunity, with expected growth of $20 billion in Egypt, $10 billion in Nigeria, and $5 billion or more in several of the continent's other large economies. Hospitality and recreation will also grow strongly. Food and beverages will remain a key category, adding nearly $30 billion in demand in Nigeria, $20 billion in Egypt, and $15 billion in Angola.

Africa's consumers vary significantly in their needs, tastes, and spending power, and companies need to segment their products and services accordingly

Africa's consumers are far from homogenous in their needs, tastes, or spending power, and companies need to take differences into account if they are to prosper. The middle class is, of course, a key market, but there is vigorous debate about the size of Africa's middle class.[59] MGI's view is that companies should consider all households with income above $5,000 a year—the level at which people typically begin spending more than half their income on discretionary items—to be consumers who they might profitably serve. We have broken African households into four income brackets: "basic needs," which describes households earning less than $5,000 a year; "emerging consumers" earning between $5,000 and $20,000; "global consumers" earning between $20,000 and $50,000; and "affluent" households earning more than $50,000.[60]

24%
of consumer spending in 2025 will be from affluent households

Using these definitions, between 50 and 60 percent of African households in 2015 belonged to the basic needs category.[61] In Nigeria and East Africa, this group makes up around half of households, compared with 24 percent in South Africa.[62] In most countries, the emerging consumer group makes up 40 percent or more of all households, comparable with the proportion in Brazil or China. Large numbers of African households are moving out of the basic needs category and entering the emerging consumer group. In East Africa alone, we estimate that more than six million households (11 percent of households) will move from earning less than $5,000 a year to earning between $5,000 and $20,000 a year by 2025. Accordingly, the share of consumption by the basic needs segment will fall in many countries.

As notable is the increasing number of higher-income households, which will be responsible for the largest share both of absolute spending and of spending growth over the next decade. We project that global consumers will make up 15 percent of Africa's population and 37 percent of spending by 2025. Affluent households will make up 6 percent of Africa's population and 24 percent of its consumer spending in 2025.

Affluent consumers already make up more than one in ten households in North Africa and South Africa and will be responsible for the large majority of the growth in household spending in those countries over the next decade at $140 billion and $34 billion, respectively (Exhibit 16). Even in East Africa and Nigeria, where affluent consumers constitute only 1 percent of households, they will command $25 billion to $30 billion of new household spending by 2025. The global consumers group will be responsible for the next largest share of spending growth in North Africa and South Africa, and the largest share in Nigeria. However, in countries such as Cameroon, Ethiopia, Ghana, and Kenya, the emerging consumer group will constitute a major share of household spending growth.

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59 *The middle of the pyramid: Dynamics of the middle class in Africa*, African Development Bank, April 2011; *Global wealth report 2015*, Credit Suisse Research Institute, October 2015; *Understanding Africa's middle class*, Standard Bank, August 2014.

60 These definitions are stated in 2005 purchasing power parity terms, which ensures comparability across regions.

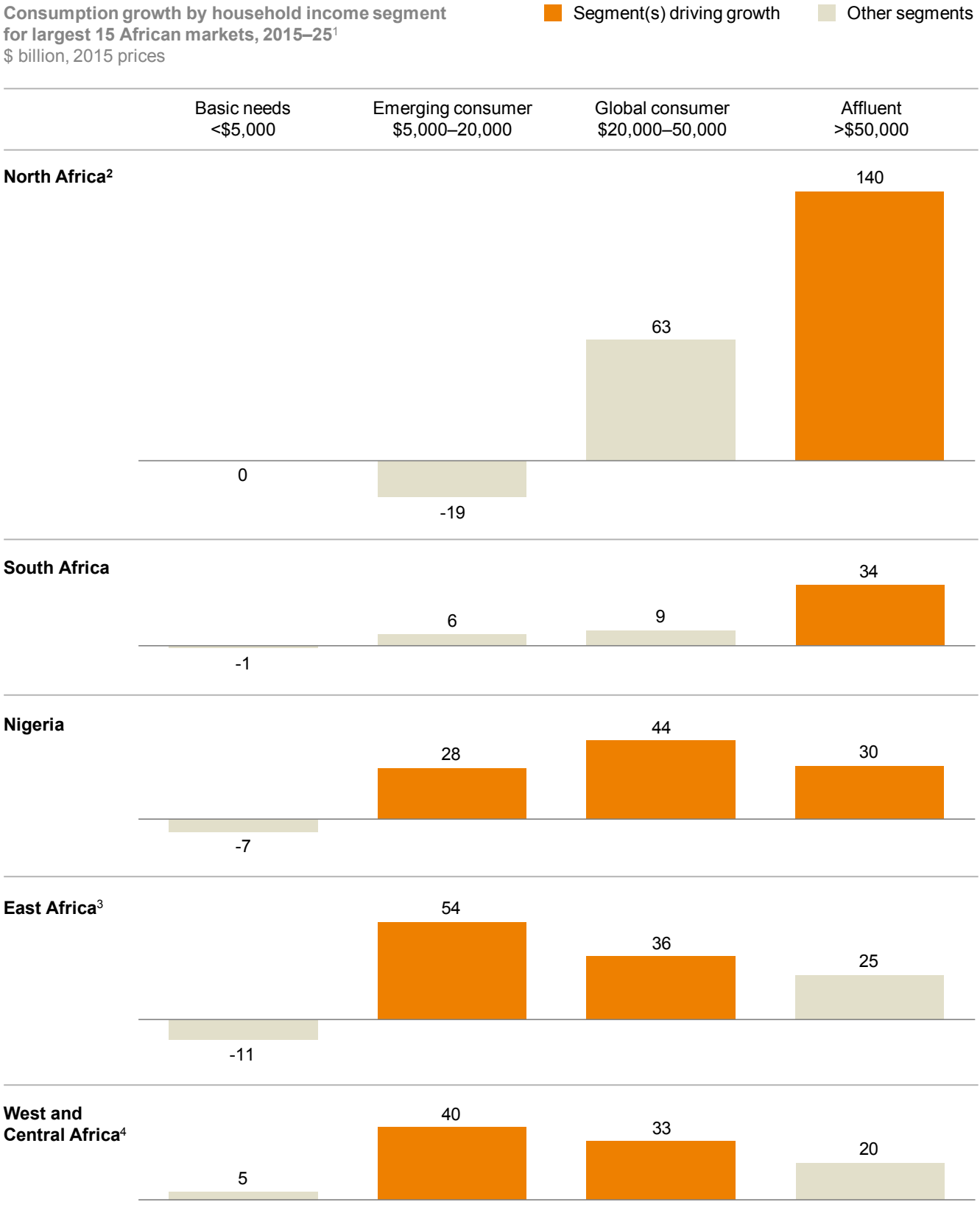
61 Range based on estimates from Canback Global Income Distribution Database (C-GIDD) and the World Bank PovcalNet database. These ranges may differ from national-level statistics because these ranges are on a purchasing power parity rather than local currency basis.

62 Basic needs consumers are a larger demographic in Africa than in markets such as Brazil, China, and India. Canback Global Income Distribution Database (C-GIDD) and the World Bank PovcalNet database.

Exhibit 16

Different segments power growth in each consumer spending pool

Consumption growth by household income segment for largest 15 African markets, 2015–25[1]
$ billion, 2015 prices



1 These 15 largest African markets generated 89% of 2015 demand and will be responsible for 82% of consumption growth between 2015 and 2025.
2 North Africa includes Algeria, Egypt, Morocco, and Tunisia. Egypt will account for 62% of the region's growth in consumption.
3 East Africa includes Ethiopia, Kenya, Sudan, and Tanzania.
4 We focus on five major markets in West and Central Africa: Angola, Cameroon, Côte d'Ivoire, Democratic Republic of Congo, and Ghana.

SOURCE: Canback Global Income Distribution Database (C-GIDD); African Development Bank; Oxford Economics; IHS; McKinsey Global Institute analysis

This analysis highlights four main pools of consumer spending—each with quite different income levels, geographic distribution, and category focus—that together will account for the large majority of new household expenditure over the next decade.[63]

- **Affluent consumers in North Africa and South Africa.** These consumers, who are better off than middle class by OECD standards, will collectively spend an additional $174 billion a year by 2025. That's 27 percent of Africa's total consumption growth over this period. Their biggest spending categories will be housing, consumer goods, education, and transportation services.

- **Nigeria.** Africa's largest economy will remain the largest single consumer market, accounting for 15 percent of the continent's growth in consumer spending to 2025. New spending will be fairly evenly split among affluent households that will spend an additional $30 billion a year by 2025, global consumers with $44 billion, and emerging consumers with $28 billion. Their biggest spending categories are expected to be food and beverages, housing, consumer goods, education, and transportation services.

- **East Africa.** Ethiopia, Kenya, Sudan, and Tanzania have two segments that will together account for 14 percent of Africa's overall consumption growth to 2025. Emerging consumers in these fast-growing East African markets are set to spend an additional $54 billion a year by 2025, and global consumers a projected $36 billion. Food and beverages will be by far the largest spending category, although there will also be sizable opportunities in housing, consumer goods, and hospitality and recreation.

- **West and Central Africa.** Two consumer segments in five distinct geographic markets—Angola, Cameroon, Côte d'Ivoire, Democratic Republic of Congo, and Ghana—will together generate 11 percent of Africa's consumption growth to 2025. These countries have roughly similar growth prospects and spending categories to the East African pool. All consumer groups in the region are set to increase spending by about $100 billion over the next decade, but just two groups—emerging and global consumers—will account for more than $70 billion of that.

15%
of growth in Africa's consumer spending to 2025 to come from Nigeria

Only 75 cities account for nearly half of Africa's household consumption

In all four spending pools—but especially among affluent and global consumers—demand will be concentrated in urban areas.[64] There is no doubt that cities are the key to profitably serving Africa's consumer markets. Africa's cities already have nearly double the per capita consumption of their national averages; Nairobi's per capita consumption is nearly three times that of Kenya as a whole (Exhibit 20). And consumption is relatively concentrated in a small number of key cities—only 75 cities across Africa accounted for 44 percent of total consumption in 2015. In Ghana and Angola, to provide just two examples, the top three cities in each country will account for two-thirds of national consumption over the next decade.

For this report, MGI commissioned research on 4,600 African consumers in six major African economies: Ethiopia, Ghana, Kenya, Morocco, Nigeria, and South Africa. Reflecting the continent's economic slowdown, reduced savings rates, and increased indebtedness, consumers with lower incomes reported that they had cut their spending on key categories over the previous year, while most higher-income households had increased their spending (see Box 1, "The impact of Africa's economic slowdown on consumer behavior and outlook").

[63] This analysis was undertaken for the top 15 consuming markets in Africa, which together made up 89 percent of demand in 2015. Contribution by these segments will therefore not add up to the total increased consumption for Africa between 2015 and 2025.

[64] Rural areas could be a second priority once the potential of urban areas is fully met, given the concentration of consumption in urban areas (approximately two-thirds) and the relatively higher cost to serve rural customers.

Box 1. The impact of Africa's economic slowdown on consumer behavior and outlook

MGI's 2016 research on African consumption finds that consumers in five of the six countries—Ethiopia is the exception—have cut back their spending.[1] Nonetheless, consumers remain optimistic about the future and aspire to buy more discretionary products.

Two-thirds of the consumers surveyed expressed worry about their finances. That figure was 78 percent in South Africa, which has experienced one of the sharper economic slowdowns on the continent. Many consumers across Africa have not been able to maintain their living standards. Half of those surveyed reported cutting their household spending over the previous year; many were drawing on savings and credit to fund day-to-day shopping (Exhibit 17). Of those who cut back, some 70 percent stopped buying products or services or bought them less often, while about 25 percent spent less on the same products and services. In all six countries surveyed, consumers reported spending less on appliances and gadgets, clothes, and cellphone airtime, and devoted less to their savings. Basic goods were less affected.

These findings correspond to a sharp slowdown in household consumption growth in most of the largest African economies between 2014 and 2015, reflecting economic deceleration and currency devaluation. For example, Nigeria's household consumption grew by just 1.5 percent during this period, compared with an annual average of 5.2 percent in 2010 to 2014. In South Africa, consumption growth fell from 3.1 percent a year in 2010–14 to 1.6 percent between 2014 and 2015. In Kenya, consumption growth declined from 6.4 percent to 4.3 percent between these two periods.

Beyond their immediate worries, African consumers are overwhelmingly optimistic about the future, with 83 percent of consumers surveyed saying that they expected their household's financial situation to improve over the next two years; in Ghana and Nigeria, topped 90 percent. Even the least optimistic consumers—in Morocco—were much more likely to think their finances would improve than deteriorate. In all six countries, most respondents said that, if they had extra money, they would spend more, particularly on discretionary items such as appliances and clothing, and also would save more (Exhibit 18).

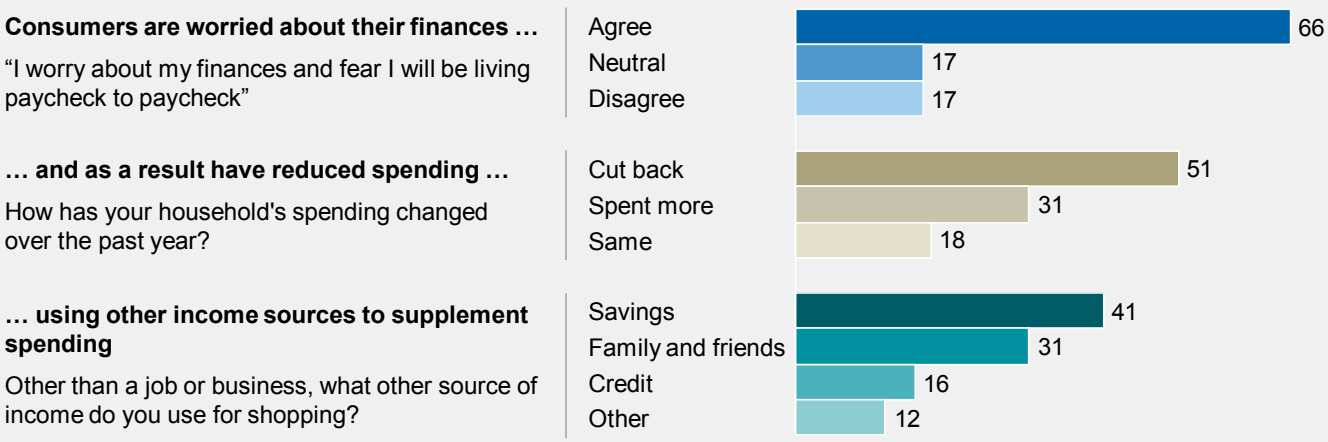
The research also broke down consumer behavior and outlook by income. This analysis confirmed the rise in the spending power of higher-income households we have noted. Despite the economic downturn, most affluent households reported spending more over the past year, just as lower-income consumers cut back; the exception to this pattern was East Africa, where stronger economic growth fueled increased spending by most emerging consumers. Unsurprisingly, higher-income households were much less price sensitive than basic needs consumers in their day-to-day purchases. However, income levels did not appear to affect consumers' degree of optimism about the future (Exhibit 19).

[1] This survey comprised 22 questions about consumer choices, perceptions about the economy, and spending habits. The questionnaire used a mobile- or SMS-based interface. All surveyed consumers lived in urban areas.

Exhibit 17

African consumers surveyed in 2016 are finding it harder to maintain living standards

% of respondents[1]



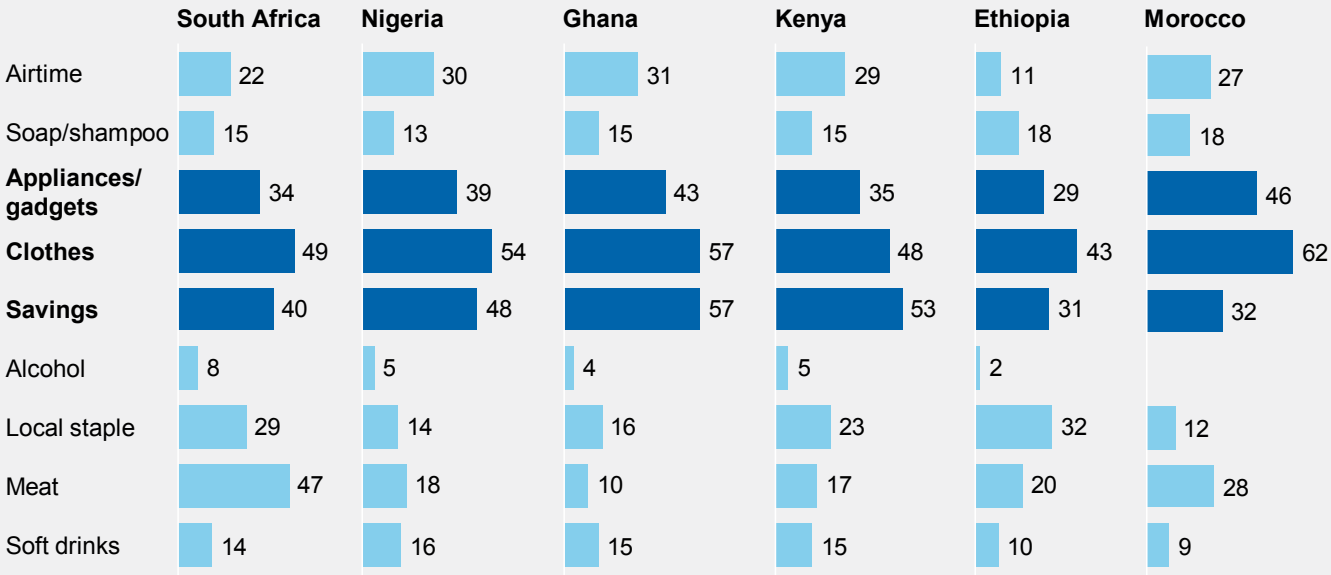
1 Results from 4,600 people surveyed in six countries: Ethiopia, Ghana, Kenya, Morocco, Nigeria, and South Africa.
NOTE: Numbers may not sum due to rounding.

SOURCE: McKinsey African Consumer Survey 2016; McKinsey Global Institute analysis

Exhibit 18

Consumers across Africa say that if they had extra money, they would spend more on clothes and appliances and would save more

If you had extra money, which of these products would you purchase?[1]
% of respondents


South Africa
Nigeria
Ghana
Kenya
Ethiopia
Morocco
Airtime 22 30 31 29 11 27
Soap/shampoo 15 13 15 15 18 18
Appliances/ gadgets 34 39 43 35 29 46
Clothes 49 54 57 48 43 62
Savings 40 48 57 53 31 32
Alcohol 8 5 4 5 2
Local staple 29 14 16 23 32 12
Meat 47 18 10 17 20 28
Soft drinks 14 16 15 15 10 9

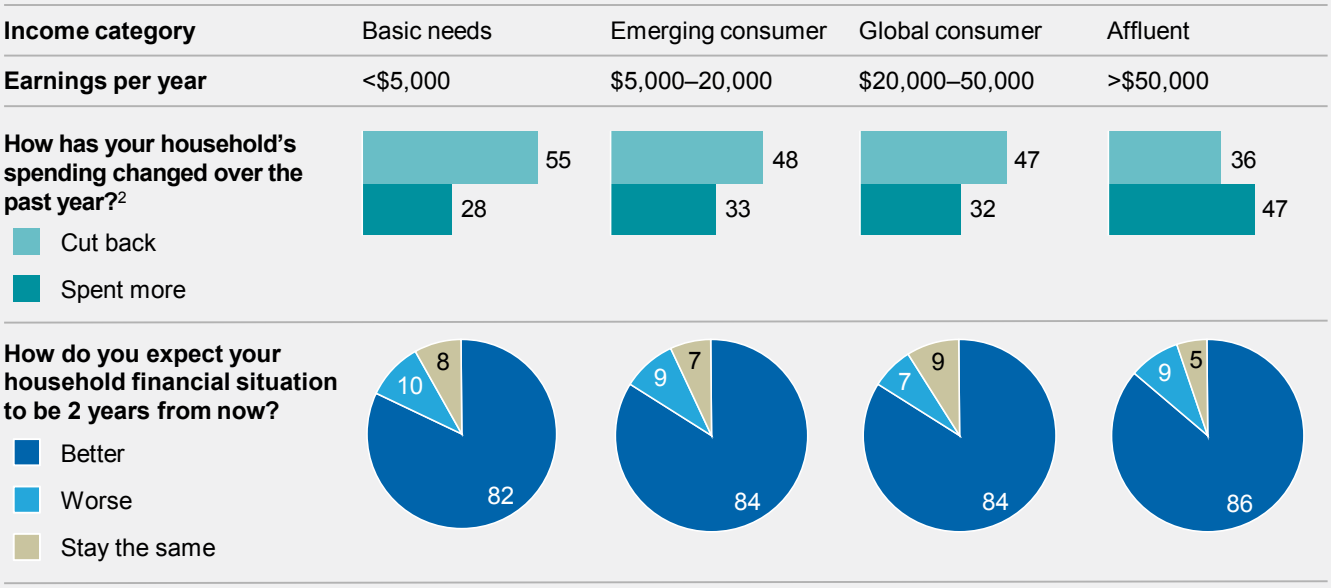
1 Multiple-response question—consumers respond to whether they would buy more of each of the selected set of products if they had extra money; total does not add up to 100%.

SOURCE: McKinsey African Consumer Survey 2016; McKinsey Global Institute analysis

Exhibit 19

Africa is divided: lower-income segments have cut spending, while those earning >$50,000 have boosted theirs

Survey respondents by income category[1]
% of respondents

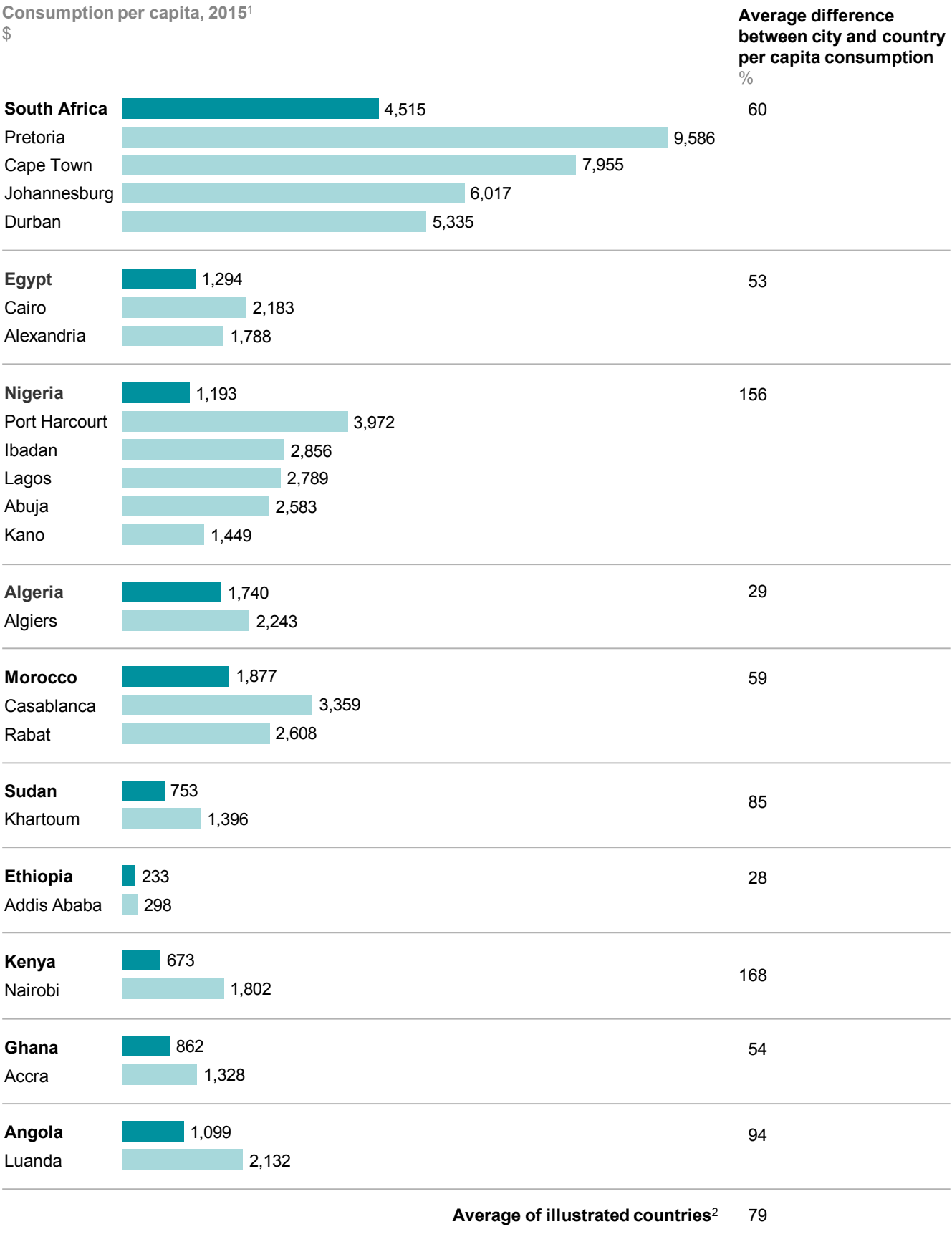


1 Aggregated across income segments for six countries: Ethiopia, Ghana, Kenya, Morocco, Nigeria, and South Africa.
2 Remaining respondents indicated that they were spending the same.
NOTE: Numbers may not sum due to rounding.

SOURCE: McKinsey African Consumer Survey 2016; McKinsey Global Institute analysis

Exhibit 20

Per capita consumption in large cities is approximately 80 percent higher than national averages



1 Four largest cities with populations above one million people included.
2 Based on the ten countries illustrated.

SOURCE: Canback Global Income Distribution Database (C-GIDD); McKinsey Global Institute analysis

Looking to the longer term, the steady growth and shifting demand patterns of Africa's consumer markets offer important opportunities for companies both serving households' basic needs and providing more sophisticated goods and services. To turn those opportunities into profitable businesses, however, companies will need to get their strategy right. First, they need to ensure that they have a meaningful presence in each of Africa's emerging centers of consumption—East Africa, Egypt, and Nigeria—with a primary focus on the largest cities in those, and other, markets. Consumer-facing companies cannot ignore Nigeria, which will continue to account for more than 20 percent of Africa's total consumption, even if the business environment proves to be challenging. Second, they need to tailor their product and service offerings, and their pricing, to Africa's distinct consumer segments. Finally, all companies need to take account of the fact that informal retail continues to lead sales in Africa. In Nigeria and Kenya, for example, more than 90 percent of consumers shop in small, local, and informal outlets.[65] Research suggests that, in many countries, middle-class consumers still prefer open-air markets to formal establishments such as malls, which are seen as higher-priced. In many sectors, therefore, companies need to design their sales and distribution approaches to cater to informal channels, and they need to enter into third-party distributor arrangements. Several firms that successfully serve African consumer markets have built distribution models based on micro-distributors—individual sales agents who deliver products by hand from a central daily distribution point. The company often provides close operational support, which might include key account management, warehousing, advice, and even regular performance assessment and dialogues. Coca-Cola and Danone have each developed variations on this model.[66]

GROWING BUSINESS-TO-BUSINESS SPENDING IS EXPECTED TO RISE TO $3.5 TRILLION BY 2025

~$2.6T
spent by businesses in Africa in 2015

While the African consumer story has generated headlines, the relatively unsung business-to-business market represents an even larger opportunity. And while the growth of B2B spending has lagged behind the growth of consumer spending over the past two decades, the gap is expected to narrow between now and 2025.[67] In 2015, companies in Africa spent some $2.6 trillion, 40 percent of it in Nigeria and South Africa (Exhibit 21). Half of that total was spent on input materials, 16 percent on capital goods, and the remainder on a wide range of services including business and financial services, transportation, and information technology (IT) and telecommunications services.[68]

Over the next decade, we expect African businesses to spend about an additional $1 trillion, bringing the continent's total B2B demand to $3.5 trillion by 2025 (Exhibit 22). Again, half of that total is expected to be spent on materials, 16 percent on capital goods, and the remainder on a broad range of services. Spending on services is set to grow the quickest at 3.5 percent a year.

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65 *So much in store: Prospects in the retail and consumer goods sector in ten sub-Saharan countries*, PwC, March 2016; *Africa: How to navigate the retail distribution labyrinth*, Nielsen, February 2015; *African powers of retailing: New horizons for growth*, Deloitte, December 2015.

66 Compiled from interviews and company websites. See Jane Nelson, Eriko Ishikawa, and Alexis Geaneotes, *Developing inclusive business models: A review of Coca-Cola's manual distribution centers in Ethiopia and Tanzania*, Harvard Kennedy School and the International Finance Corporation, May 2009; and *Bringing healthy affordable nutrition to the BOP: A Danone initiative*, Danone fact sheet, June 2008.

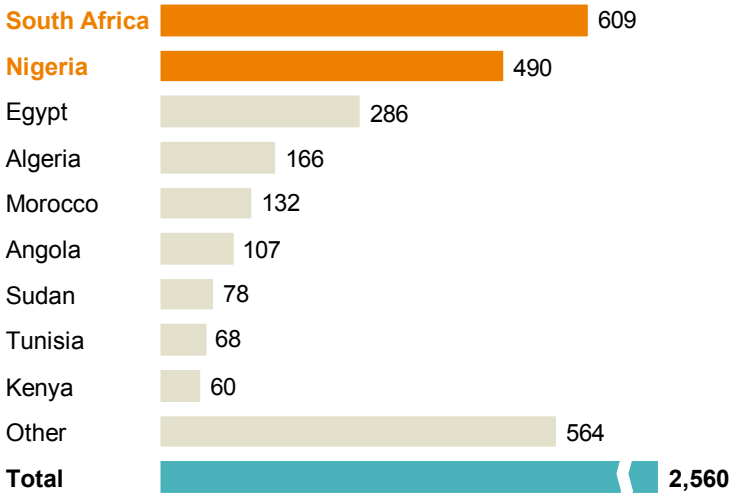
67 From 1995 to 2015 period, the B2B markets of seven of Africa's largest economies—Cameroon, Egypt, Kenya, Morocco, Nigeria, Senegal, and South Africa—grew at a multiple of 0.7 times the GDP growth rate, while consumer markets in these countries grew at 0.9 times the GDP growth rate. These multiples are similar to the ones in other emerging markets including Brazil, China, and India. Between 2015 and 2025, Africa's B2B markets are expected to grow at 0.8 times the GDP growth rate, only slightly behind the growth of consumer markets at 0.9 times GDP.

68 All values reported in 2015 prices, based on real growth rates. Estimated B2B spending excludes salaries.

Exhibit 21

Companies spend ~$2.6 trillion a year—almost 40 percent of that in Nigeria and South Africa

Company spending by country (excluding salaries), 2015[1]
$ billion



	2015–25 Growth $ billion	2015–25 Growth rate %
South Africa	148	2.2
Nigeria	220	3.8
Egypt	115	3.4
Algeria	16	0.9
Morocco	43	2.9
Angola	28	2.4
Sudan	26	2.9
Tunisia	24	3.1
Kenya	33	4.5
Other	317	4.6
Total	**970**	**3.3**

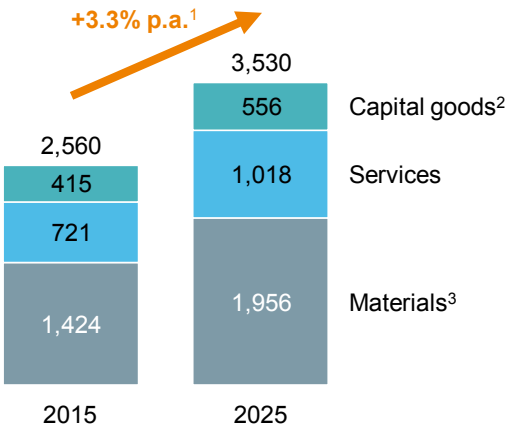
1 Spending excludes salaries (22%) but includes spending on materials, services, and capital expenditure.
NOTE: Numbers may not sum due to rounding.

SOURCE: MGI African companies database; CIQ database; IHS; WCIS; Yankee; Ovum; BMI; McKinsey Purchasing and Supply Management Practice; McKinsey BMI Practice; McKinsey Oil and Gas Practice; McKinsey Global Banking Pools; McKinsey Global Institute analysis

Exhibit 22

Business-to-business spending could grow to $3.5 trillion by 2025

Spending by African businesses (excluding salaries)
$ billion



	2015–25 Growth $ billion	2015–25 Growth rate %
Capital goods[2]	141	3.0
Services	297	3.5
Materials[3]	532	3.2

1 Each country's spending in 2025 was estimated based on growth forecasts by sector and country, from either IHS or a McKinsey Practice.
2 Defined as the average capital spending by a company in this sector (smoothing out the effect of large capital expenditure projects).
3 Includes material costs that are directly attributed to the cost of production (as part of the finished product) and material costs that do not form a part of the finished product (indirect costs).
NOTE: Numbers may not sum due to rounding.

SOURCE: MGI African companies database; CIQ database; IHS; WCIS; Yankee; Ovum; BMI; McKinsey Purchasing and Supply Management Practice; McKinsey BMI Practice; McKinsey Oil and Gas Practice; McKinsey Global Banking Pools; McKinsey Global Institute analysis

Three key trends will boost the demand by African businesses for input materials, capital goods, and services.

- **Structural changes in Africa's business sector.** Continued formalization of African businesses will increase productivity, scale, access to funding, and demand for B2B sales. Africa, especially sub-Saharan Africa, has low levels of business registration, but governments are putting greater focus on legislation and social policy to bring informal businesses into the formal economy. Several of Africa's regional trade blocs are achieving notable successes in creating larger markets and encouraging cross-border trade of goods and services (see Chapter 3 for further discussion). This will encourage increased local production and services based in these regions, thereby developing regional value chains and increasing the level of business spending on the continent.

- **Urbanization and business clustering.** Africa's rapid urbanization is supporting the emergence of business clusters that stimulate productivity, innovation, and the creation of new businesses. One example is Morocco's Tangier Free Zone, established in 2001; by 2009, the zone hosted 475 companies. Another example is the Eastern Industrial Zone in Ethiopia, established in 2010; at the time of writing in 2016, this zone hosted 27 companies. A third example is the high-tech cluster in Nairobi, Kenya, which has hosted IBM's first African research center since 2013.[69]

- **Technological change.** Rapid advances in technology, which is cutting costs, could give a significant boost to Africa's business growth. Digitization and automation simplify operations and potentially increase share of spending on capital goods. Technology is creating opportunities for African businesses to leapfrog ahead in sectors such as financial services, and retail and wholesale, and open up new markets. One new market is the development and rapid spread of mobile wallets in East Africa.

The mix of sector demand is shifting

Today, Africa's B2B market is dominated by five groups of sectors that together account for more than 80 percent of spending: agriculture and agri-processing; manufacturing; construction, utilities, and transportation; wholesale and retail; and resources (Exhibit 23). Input materials make up the large majority of spending in all these sectors except manufacturing, in which capital goods accounted for 40 percent of B2B expenditure in 2015.

Technology is creating opportunities for African businesses to leapfrog ahead in sectors such as financial services, and retail and wholesale, and open up new markets.

In the decade ahead, most of the major sectors will experience substantial growth in demand, but some will grow much faster than others in a continent undergoing rapid development and change. We estimate that construction, utilities and transportation will add $215 billion in spending in the period to 2025. This is more than any other sector, reflecting the rapid growth of Africa's cities, housing markets, and infrastructure. Agriculture and

[69] IBM. Also see Alexander Böhmer, *Key lessons from selected economic zones in the MENA region*, MENA-OECD Investment Programme, OECD, paper delivered at the first meeting of the working group on investment zones in Iraq in Amman, Jordan, March 29–30, 2011, and Peter Gakunu et al., *If Africa builds nests, will the birds come? Comparative study on special economic zones in Africa and China*, United Nations Development Programme, December 2015.

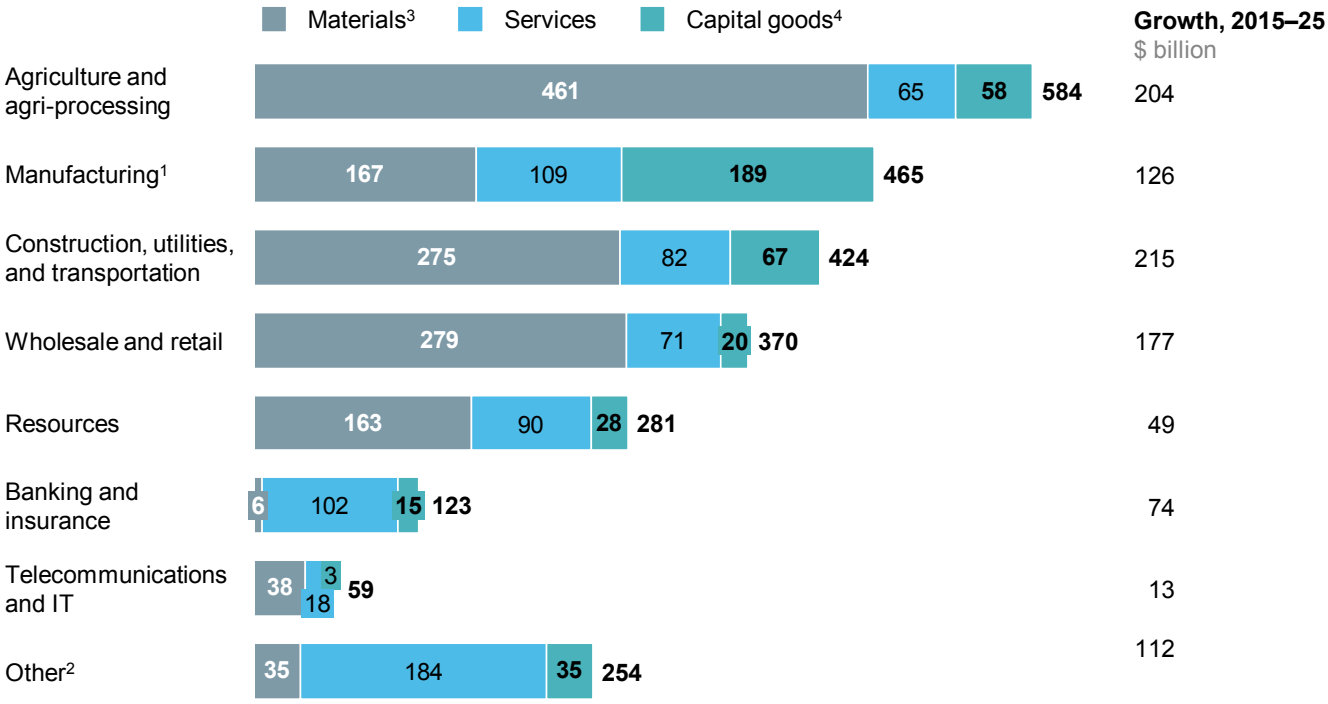
agri-processing, which is already a B2B market worth nearly $600 billion, is expected to spend an additional $204 billion in the period to 2025. This is due to growing populations and rising incomes boosting demand for agricultural and more sophisticated food products. Manufacturing is expected to spend an additional $126 billion to ramp up production as domestic demand for industrial goods increases at a rapid rate.

To meet the needs of Africa's fast-growing, urbanizing consumer markets, we expect the wholesale and retail sector to spend an additional $177 billion by 2025, while the financial services sector is projected to increase its spending by 60 percent, adding $74 billion in the period to 2025. It is worth noting that company expenditure in the resources sector will grow at just 1.6 percent a year—an additional $49 billion by 2025—reflecting the fact that the slump in commodity prices is having a lasting effect on investment in the sector. B2B spending by the telecommunications and IT sector is also expected to grow more slowly due to high penetration rates, along with declining average revenue per user as competition intensifies and the price of technology falls. The estimate is based on revenue for voice and data; enterprise services or innovative new consumer products may yet emerge as a significant source of telecommunications growth.

Exhibit 23

Africa's business sectors have distinct spending profiles

Company spending by sector and category (excluding salaries), 2015
$ billion



1 Heavy, light, and R&D-intensive manufacturing.
2 Health care, other services, and smaller sectors.
3 Material costs directly attributed to the cost of production (as part of the finished product) and material costs that do not form a part of the finished product.
4 Defined as the average capital expenditure by a company in this sector (smoothing out the effect of large capital expenditure projects).
NOTE: Numbers may not sum due to rounding.

SOURCE: MGI African companies database; CIQ database; IHS; WCIS; BMI; Ovum; Yankee; McKinsey Purchasing and Supply Management Practice; McKinsey BMI Practice; McKinsey Oil and Gas Practice; McKinsey Global Banking Pools; McKinsey Global Institute analysis

Business demand for services is growing strongly, and demand for materials and capital goods is recovering

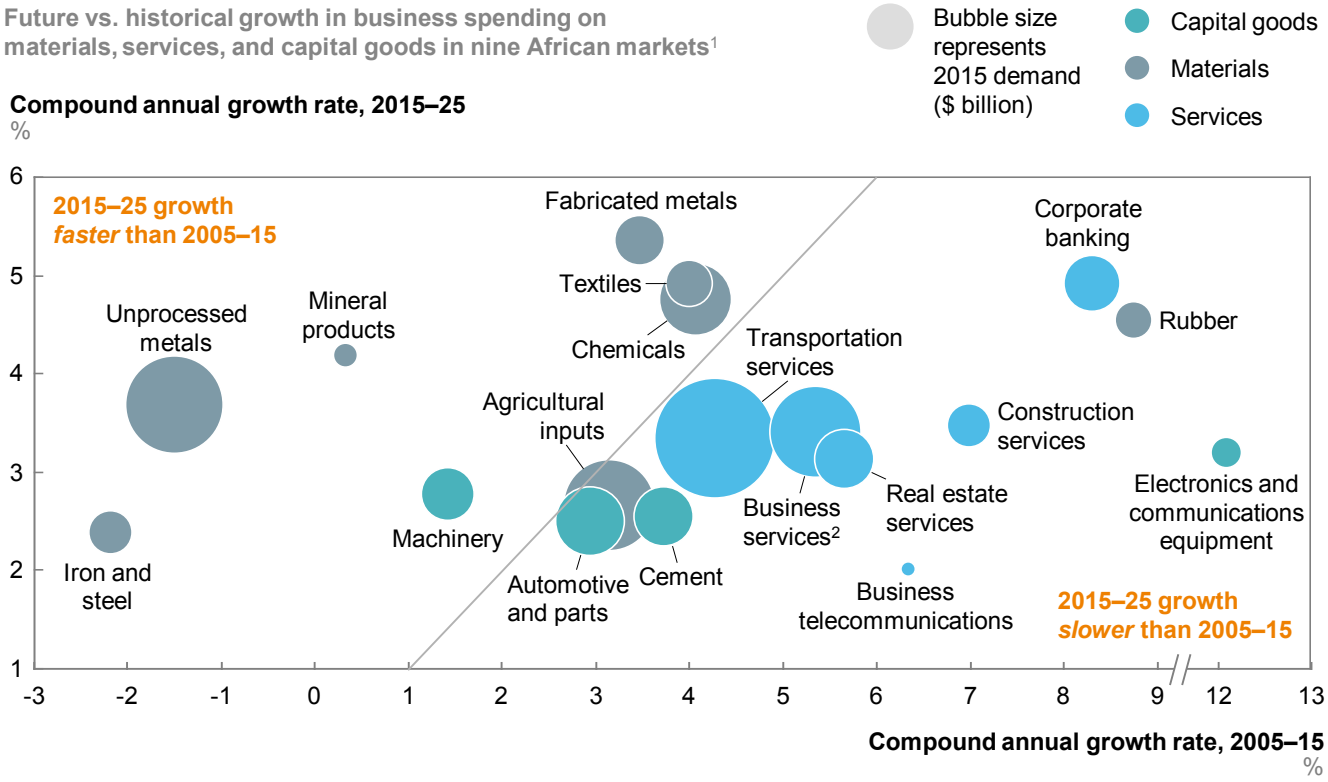
To understand how demand is evolving for particular business inputs, MGI undertook a detailed analysis of the market for materials, capital goods, and services for nine African markets, looking at both the past decade and the next ten years.[70] Overall, demand for services grew the fastest between 2005 and 2015. Spending on corporate banking grew by 8 percent a year, on telecommunications services at 6 percent, on business services such as accounting and legal at 5 percent, and on transportation at more than 4 percent. By contrast, demand for materials and capital goods has grown more slowly over the past decade as less demand in South Africa offset rising demand in other markets. Demand for agricultural inputs was an exception, growing at 3 percent a year between 2005 and 2015 as Africa's food and beverages sector expanded to feed a growing population. Chemicals sales experienced significant growth of 4 percent a year, also likely because of rising consumer demand.

We expect demand for services to continue to grow strongly as Africa's business sector grows in size and sophistication. The fastest-growing category is likely to be corporate banking services. We also expect a recovery in demand for materials and capital goods. In particular, demand for building materials such as fabricated metals is likely to accelerate as construction booms in Africa's growing cities, and demand for machinery and unprocessed metals will accelerate as the continent's manufacturing sector expands (Exhibit 24).

Exhibit 24

Demand for materials will strengthen

Future vs. historical growth in business spending on materials, services, and capital goods in nine African markets[1]



1 Data are for nine countries: Cameroon, Egypt, Kenya, Morocco, Nigeria, Senegal, South Africa, Tunisia, and Zimbabwe.
2 Includes business activities such as legal, accounting, bookkeeping and auditing activities; tax consultancy; market research and public opinion polling; business and management consultancy; architectural, engineering, and other technical activities; advertising; computer programming; and R&D.

SOURCE: MGI African companies database; CIQ database; IHS; WCIS; Yankee; Ovum; BMI; UNCTAD; McKinsey Purchasing and Supply Management Practice; McKinsey BMI Practice; McKinsey Oil and Gas Practice; McKinsey Global Banking Pools; McKinsey Global Institute analysis

[70] The analysis included countries where data were available: Cameroon, Egypt, Kenya, Morocco, Nigeria, Senegal, South Africa, Tunisia, and Zimbabwe.

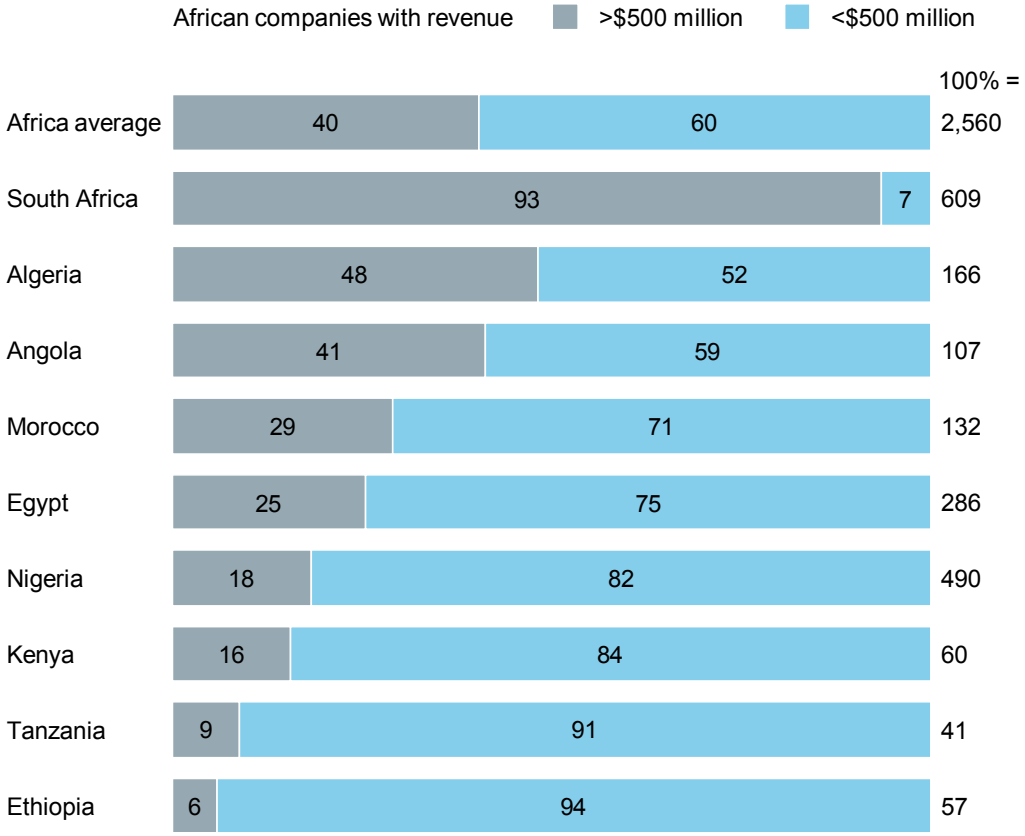
Companies need to target particular B2B segments to be successful

The extent and diversity of the B2B market means that businesses seeking to serve it profitably will need to be thoughtful about targeting particular segments of companies. Smaller companies with annual revenue of less than $500 million account for more than 60 percent of Africa's total B2B spending. In Ethiopia and Tanzania, these smaller firms generate more than 90 percent of B2B spending. In Kenya and Nigeria, that figure is more than 80 percent (Exhibit 25). Looking at sectors, agri-processing, construction, utilities, and transportation are all highly fragmented, and they therefore require a broad-based sales approach. Across the continent, smaller companies were responsible for nearly 90 percent of demand in the agriculture and agri-processing sector in 2015 and more than 50 percent of demand in most other sectors. Only resources, financial services, and telecommunications and IT have a high degree of consolidation.

Exhibit 25

Smaller companies will account for most business spending in countries other than South Africa

Share of company spending by company scale, 2015
%; $ billion



NOTE: Numbers may not sum due to rounding.

SOURCE: MGI African companies database; CIQ database; IHS; WCIS; BMI; Ovum; Yankee; McKinsey Purchasing and Supply Management Practice; McKinsey BMI Practice; McKinsey Oil and Gas Practice; McKinsey Global Banking Pools; McKinsey Global Institute analysis

Given the predominance of smaller businesses in Africa, companies need a clear plan to serve them, including tailored offerings, targeted sales forces, and distribution and supply chains appropriate to their needs. These smaller companies are well worth developing as customers. Many of them are growing rapidly and will make an important contribution to Africa's growth. Nevertheless, large companies are a major market in some countries. Firms with annual revenue exceeding $500 million account for 93 percent of South Africa's B2B demand, 48 percent of Algeria's, and 41 percent of Angola's. Given the overall size of South Africa's B2B market—more than $600 billion in 2015—a meaningful presence in that country is an important starting point from which to expand into other regions.

Given the predominance of smaller businesses in Africa, companies need a clear plan to serve them, including tailored offerings, targeted sales forces, and distribution and supply chains appropriate to their needs.

•••

Strong growth in consumer and B2B spending makes Africa a very exciting market. Local and global firms that tailor their offerings to the continent's diverse consumer segments and business clusters have a tremendous opportunity for profitable growth. In the next chapter, we turn to prospects for a step change in Africa's manufacturing output—another major potential opportunity.

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3. UNLEASHING AN AFRICAN INDUSTRIAL REVOLUTION

One business sector, manufacturing, stands out as a major untapped opportunity—and even imperative—for growth in Africa. MGI estimates that the continent could double its manufacturing output in just ten years, thereby boosting GDP and productivity growth, improving countries' balance of payments, and creating between six million and 14 million stable jobs. Much of the growth is likely to be focused in countries with existing manufacturing hubs, but several other countries will have industrialization opportunities in specific niches.

6M–14M
stable jobs could be created through increased manufacturing output

Three-quarters of the opportunity could come from meeting soaring consumer and B2B demand domestically, reducing the volume of goods and services that is imported. The rest could come from boosting exports such as automobiles, chemicals, and electrical machinery. Several African industrial clusters have achieved rapid growth over the past decade, including Ethiopia's apparel and footwear sector and Morocco's automotive and aerospace industries. Other countries and sectors have an opportunity to draw on similar advantages, including abundant labor and access to key markets, and to build globally competitive export hubs in a variety of industrial sectors.

Achieving a doubling of Africa's manufacturing output will be challenging. Africa's manufacturing production has grown more slowly than imports in recent years, and its rate of growth has been well behind that of faster-industrializing Asian countries such as China, India, and Vietnam. Businesses and governments need to be proactive in taking bold steps to accelerate industrialization. Priorities include efforts to improve market access, further integrate into global supply chains, and increase competitiveness through improved labor productivity and expanded, better-operated power and transportation infrastructure.

Several African industrial clusters have achieved rapid growth over the past decade, including Ethiopia's apparel and footwear sector and Morocco's automotive and aerospace industries.

MANUFACTURING IS A CRITICAL ENGINE OF ECONOMIC DEVELOPMENT

Manufacturing is a powerful force for development and economic growth. This sector builds the machines that enable agriculture and other sectors to become more productive, provides the materials and tools to build and operate infrastructure, enables people to earn higher incomes, and creates new products that open up new opportunities for growth in service sectors. Manufacturing is a strong driver of productivity and innovation, accounting for up to 90 percent of private research and development (R&D) spending. Diversification into manufactured goods can also boost exports, helping countries to earn hard currency and improve current-account balances.

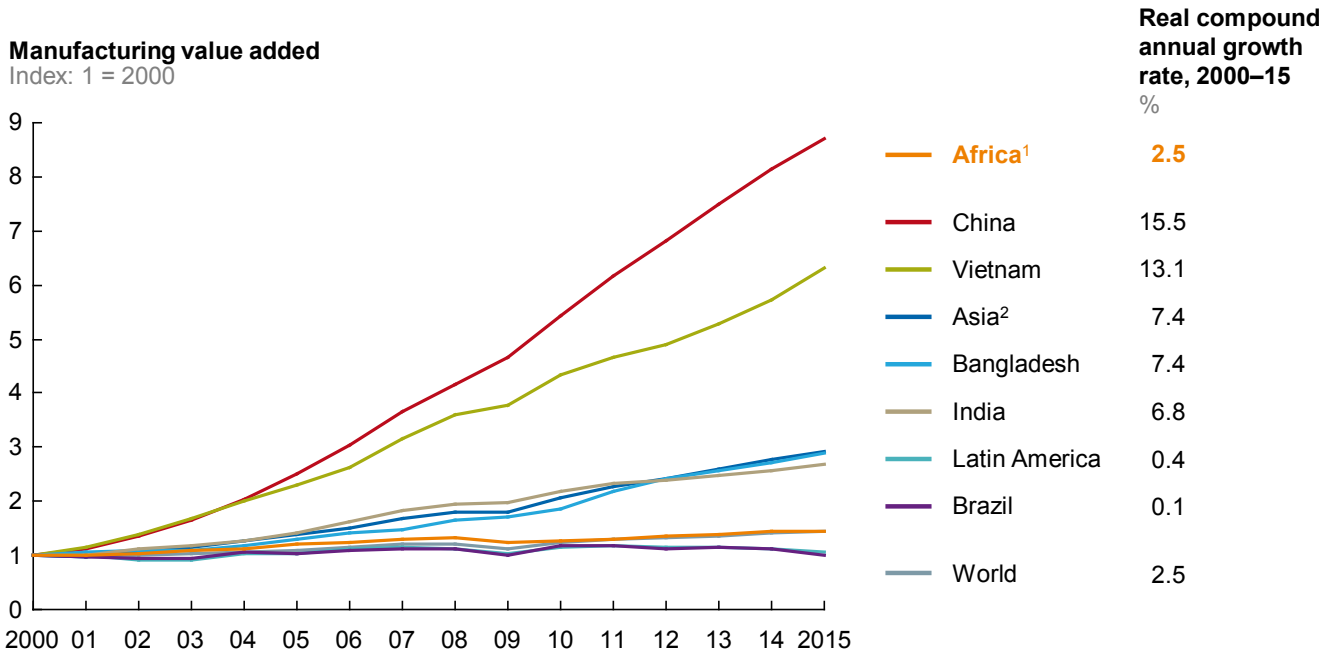
Previous MGI research has focused on manufacturing as a critical engine of development, providing a path to middle- and high-income status for developing economies.[71] Contributing to this engine of growth has been the creation of low-skilled jobs as countries have urbanized. Few countries have skipped the industrial stage in their move to wealthy-nation status.[72] However, manufacturing is not monolithic; understanding this diversity is critical to pinpointing Africa's opportunity (see Box 2, "Five distinct categories of manufacturing"). Not all African countries will be able to position themselves to benefit from significant manufacturing growth, but those that are able to improve competitiveness and break into the sector could establish a significant cluster at scale. But it is critical that they act fast: the rapid pace of automation means African nations have a limited window of opportunity to grow manufacturing.

AFRICA HAS SIGNIFICANT UNTAPPED POTENTIAL IN MANUFACTURING

As African economies have grown and diversified over the past two decades, the continent has experienced a steady increase in its manufacturing output. The industrial sectors in Ethiopia, Tanzania, and a few other countries have expanded rapidly. But Africa is not industrializing to its full potential. Between 2000 and 2015, its manufacturing value added grew at 2.5 percent a year, which is on a par with the world average and ahead of the pace in Latin America (and Brazil in particular), but far behind the rate of growth observed in Asia, where manufacturing value added grew at 7.4 percent a year (Exhibit 26).

Exhibit 26

Since 2000, Africa's manufacturing value-added growth has equaled the global average but has lagged behind that of emerging Asian champions



1 Cameroon, Egypt, Kenya, Morocco, Nigeria, Senegal, South Africa, Tunisia, and Zimbabwe.
2 Bangladesh, China, Hong Kong, India, Indonesia, Japan, Malaysia, Pakistan, Philippines, Singapore, South Korea, Sri Lanka, Taiwan, and Thailand.

SOURCE: IHS; McKinsey Global Institute analysis

[71] *Manufacturing the future: The next era of global growth and innovation*, McKinsey Global Institute, November 2012.

[72] A number of economies grew rich via exports of primary resources, notably oil—allowing them to import the technology they required. Yet many resource-rich economies suffer from "Dutch disease," a phenomenon in which, because of a nation's resource wealth, other sectors have less incentive to pursue productivity improvements.

Box 2. Five distinct categories of manufacturing

MGI's research emphasizes the wide diversity of manufacturing industries and how the requirements for success differ among broad industry groups and even within subsectors. MGI segments manufactured goods into five groups that differ considerably in the composition of cost, their innovation levels, and tradability. The groups are named to reflect their most important characteristics (Exhibit 27). For example, in the global innovation for local markets category, which includes such industries as automobiles, equipment, and machinery, R&D is a large cost and competition revolves around innovation and new products. In labor-intensive tradables, which includes industries such as textiles and apparel, low-cost production is critical to success and end products are shipped from low-cost production sites to customers around the globe.

In only two segments does significant global trade occur for finished goods, and they are at opposite ends of the skill spectrum: labor-intensive tradables and global technologies segments such as semiconductors and electronics. The remaining three segments are marked by varying degrees of local or regional focus, driven by access to markets, resources, or knowledge clusters, and by costs of shipping relative to product value. In the global innovations category, some 40 to 50 percent of products are traded globally, and the remainder are produced or assembled for local or regional markets. The regional processing sector—including food and beverages, plastics, and fabricated metals—has lower international tradability due to complex and costly logistics. Finally, resource-intensive products such as cement and basic metals provide commodity-type inputs to other sectors, and generally have low tradability.

Exhibit 27

MGI has identified five groups of manufacturing industries with very different characteristics and requirements

Sector	**Manufacturing share of value added** (%) Global	Africa[1]	Traits	Industry examples
Global innovation for local markets	34	27	▪ Competition based on innovation and quality; high R&D intensity (5–25%)[2] ▪ Some components traded globally (40–50% trade intensity) with more regional assembly and production[3]	▪ Chemicals and pharmaceuticals ▪ Transportation equipment including automotive ▪ Machinery, electrical machinery, appliances
Regional processing	28	38	▪ Low tradability (5–20% trade intensity)[3] ▪ Highly complex and costly logistics ▪ Freshness requirements and local tastes drive proximity need ▪ Relatively automated; little R&D	▪ Rubber and plastics ▪ Fabricated metals ▪ Food and beverages ▪ Printing and publishing
Resource-intensive	22	22	▪ Provide commodity-type inputs to other sectors; low tradability ▪ Energy- and resource-intensive (energy intensity 7–15%)[4] ▪ Price competition; little differentiation	▪ Wood products ▪ Paper and pulp ▪ Basic metals ▪ Minerals-based products ▪ Refined petroleum, coke products, and nuclear products
Global techno-logies	9	2	▪ Competition based on R&D and cutting-edge technology, with high R&D intensity (25–35%)[2] ▪ Highly tradable (55–90% trade intensity) in both components and final products[3]	▪ Computers and office machinery ▪ Semiconductors and electronics ▪ Medical, precision, and optical equipment
Labor-intensive tradables	7	11	▪ High labor intensity (30–35 hours per $1,000 value added)[5] ▪ High exposure to price competition ▪ Globally traded (50–70% trade intensity); low proximity needs[3]	▪ Textiles, apparel, leather ▪ Furniture, jewelry, toys, and other manufactured goods not classified elsewhere

1 Estimated for nine countries in Africa: Cameroon, Egypt, Kenya, Morocco, Nigeria, Senegal, South Africa, Tunisia, and Zimbabwe.
2 R&D intensity = R&D expenditure divided by value added (nominal), United States, 2007.
3 Trade intensity = exports divided by gross output (nominal), world, 2006-10 average.
4 Energy intensity = cost of purchased fuels and electricity divided by value added (nominal), United States, 2010.
5 Labor intensity = hours worked per $1,000 value added (nominal), EU-15, 2007.

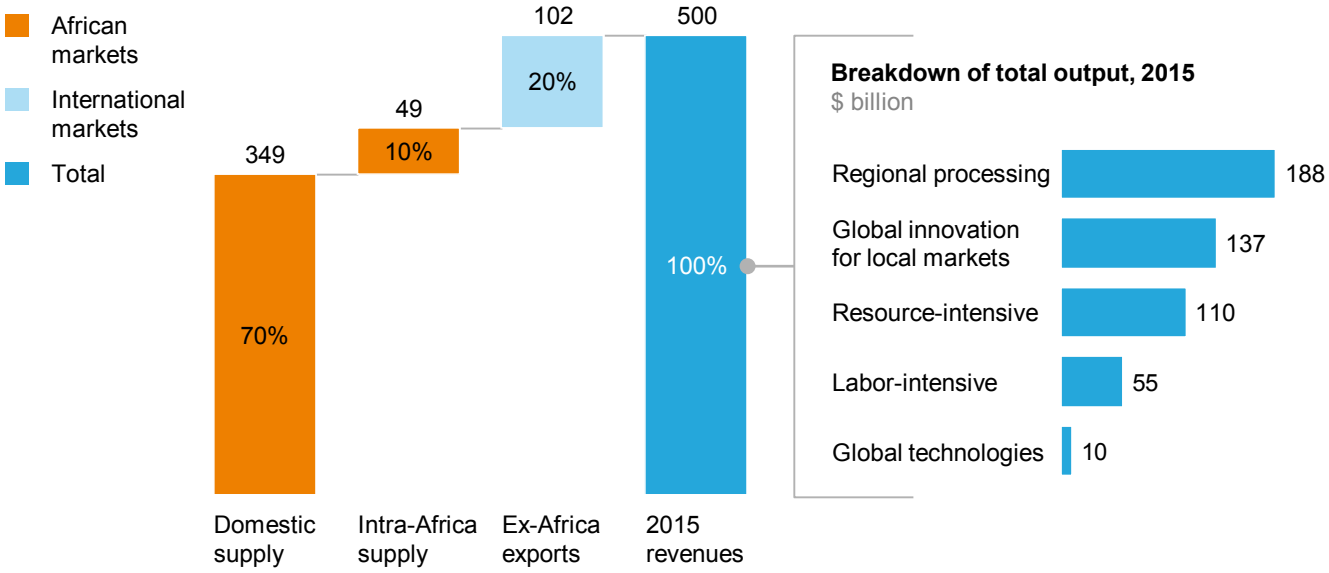
SOURCE: OECD; "Annual survey of manufactures," US Census Bureau, May 2010; "Commodity flow survey," US Census Bureau and US Bureau of Transportation Statistics, 2007; IHS; McKinsey Global Institute analysis

In 2015, Africa's manufacturing output was worth around $500 billion (Exhibit 28). The vast majority of manufacturing capacity is concentrated in five countries: Egypt, Morocco, Nigeria, South Africa, and Tunisia.[73] Seventy percent of this production was focused on meeting domestic needs and was consumed in the country of manufacture. About 10 percent was traded within Africa, and only 20 percent exported beyond Africa.

Exhibit 28

Africa manufactures $500 billion of products—80 percent of them for markets within the region

Africa's production of manufacturing goods, 2015
$ billion



SOURCE: UNCTAD; IHS; McKinsey Global Institute analysis

Using the five categories listed in Box 2, we find that the breakdown of Africa's manufacturing output reflects this strong domestic focus. Regional processing made up nearly 40 percent of the continent's industrial output in 2015, with food and beverages and fabricated metal accounting for four-fifths of this share. Global innovations for local markets, including chemicals, automotive manufacturing, and machinery, made up a further 27 percent of the total. Resource-intensive manufacturing, Africa's largest export category, accounted for only 20 percent of total output; major subcategories were petroleum products and processed minerals and metals. The continent's relatively small labor-intensive manufacturing sector—focused on textiles, apparel, and footwear—made up most of the balance. Global technologies, including communications equipment and medical devices, generated only 2 percent of total output (because of its small scale, we do not investigate this category in further detail in this report).

Africa's share of global manufacturing exports has been in a narrow band between 1 percent and 1.5 percent since 2000; the share was 1.4 percent in 2014. In comparison, China's share of the global total grew from 4.5 percent in 2000 to 15 percent in 2014. Other Asian countries such as Bangladesh and Vietnam also achieved rapid growth in manufacturing exports by matching low labor costs with active steps to attract investment, develop skills, and broaden access to international markets through trade agreements.

[73] The estimated value added is expressed in 2015 prices and consolidated from several sources: the IHS World Industry Service, the United Nations Statistics Division, national statistical offices, and Lars Christian Moller, *Ethiopia's great run: The growth acceleration and how to pace it*, World Bank working paper number 99399, November 2015.

(France, Germany, Japan, the United States, and other traditional manufacturing nations, meanwhile, have all experienced a declining share.)

3%
a year fall in Africa's share of global labor-intensive manufacturing exports over past decade

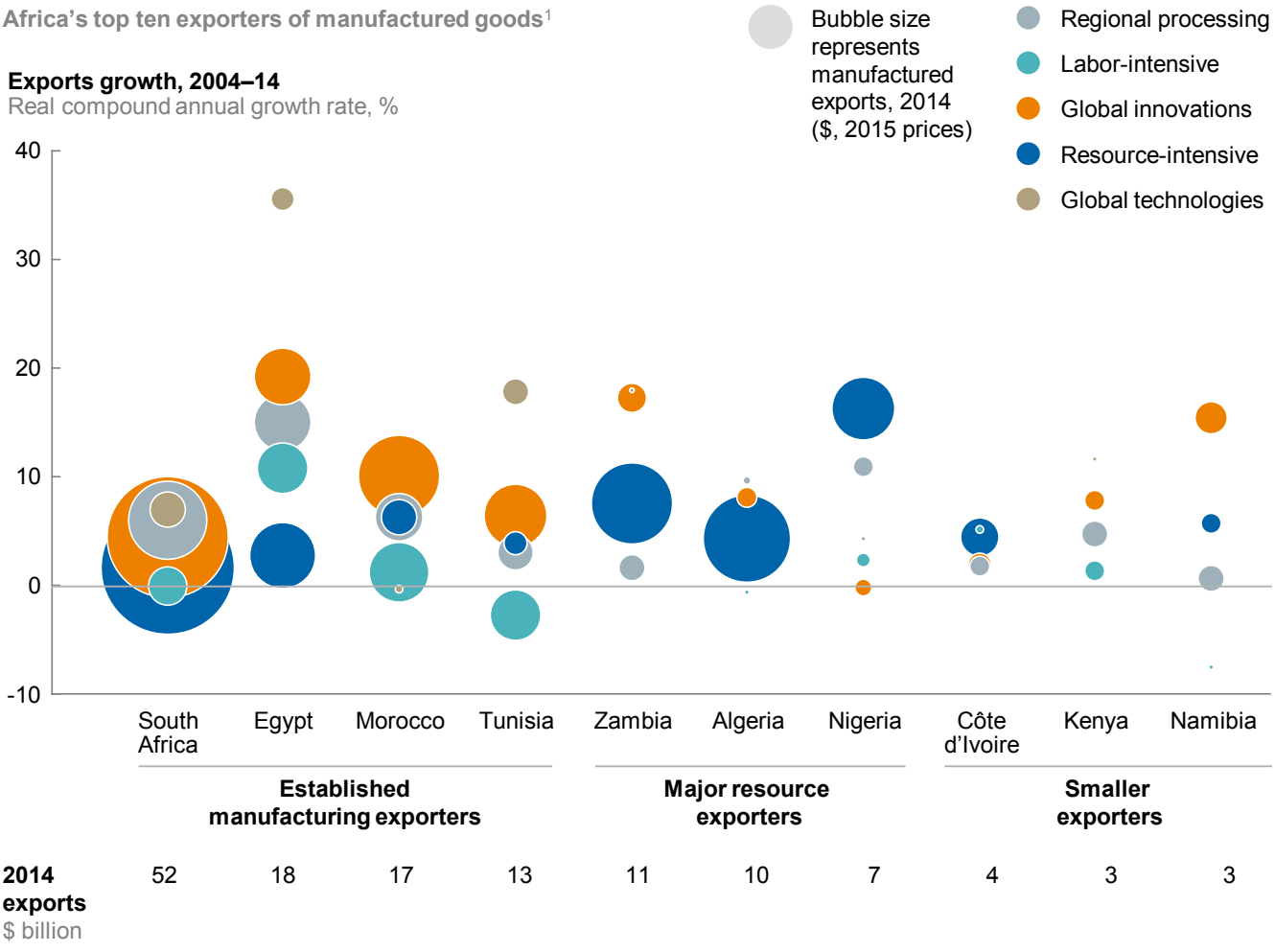
Africa's performance on different categories of manufacturing exports has varied. In the global innovations category, its share of global exports has grown by around 3 percent a year in real terms over the past decade to reach $47 billion in 2014. However, Africa's share of global labor-intensive manufacturing exports fell by 3 percent a year over this period, even as its output grew from $16 billion in 2004 to $18 billion in 2014.

There were variations in performance among countries, too. Established African exporters of manufactured goods such as Egypt, Morocco, and South Africa all achieved significant growth in the export of global innovations between 2004 and 2014; Kenya did, too. The well-developed automotive sectors in Morocco and South Africa increased exports during this period, and Egypt increased exports of chemicals and electrical machinery. However, these economies' exports of labor-intensive goods mostly stagnated or declined. Major resource exporters, notably Algeria, Nigeria, and Zambia, all expanded their exports of resource-intensive manufactured goods, but these countries' exports in other categories remained small. This left their economies and trade balances vulnerable to resource price shocks (Exhibit 29).

Exhibit 29

African manufacturing countries have increased exports in differing categories of goods

Africa's top ten exporters of manufactured goods[1]



1 Top ten account for 77% of total manufactured exports.

SOURCE: UNCTAD; McKinsey Global Institute analysis

AFRICA HAS AN OPPORTUNITY TO DOUBLE MANUFACTURING OUTPUT TO NEARLY $1 TRILLION BY 2025

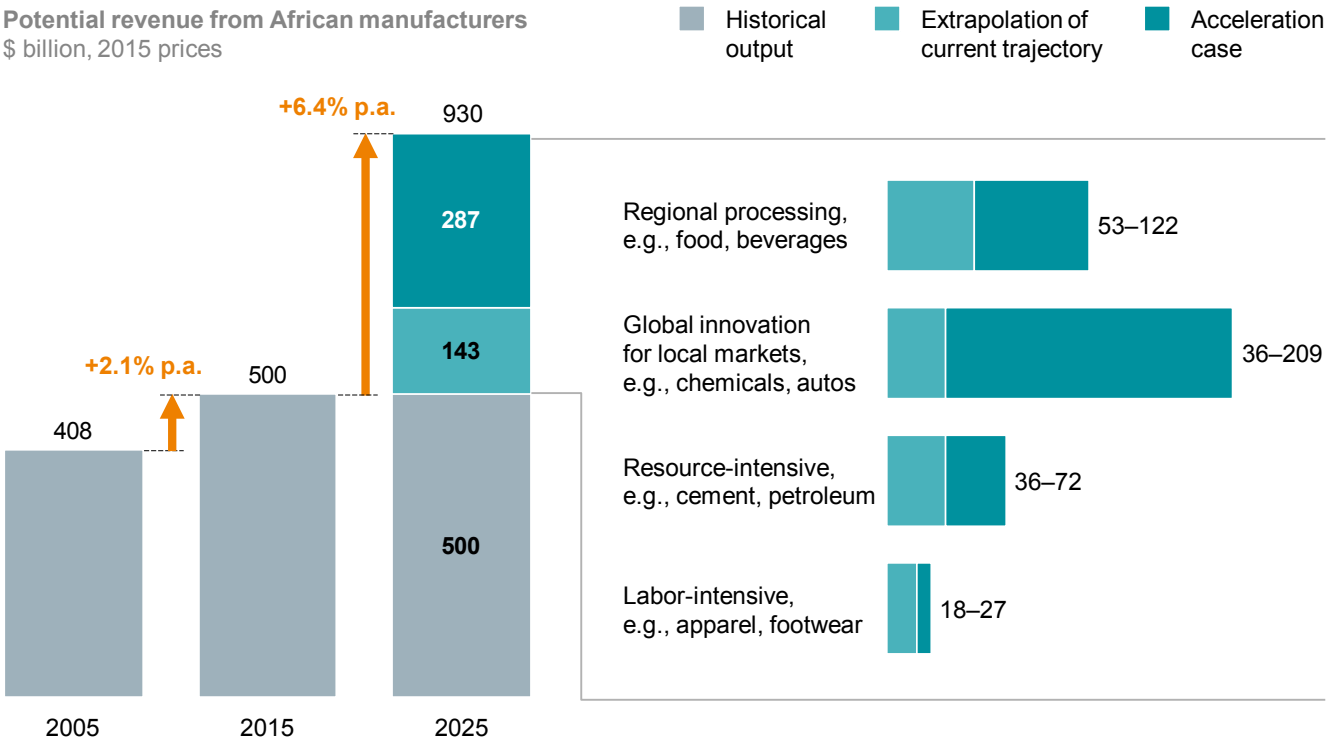
Over the past decade, some parts of Africa's manufacturing have become internationally competitive and achieved rapid growth in certain categories and countries. This, combined with fast-growing demand from local consumer and B2B markets, suggests that there is potential to accelerate industrialization much more broadly across the continent.

Three-quarters of potential growth in manufacturing output would come from meeting intra-African demand and substituting imports of manufactured goods.

MGI estimates that, by 2025, Africa could nearly double its current manufacturing output to $930 billion—this would entail annual growth of 6.4 percent, triple the rate achieved since 2000 (Exhibit 30). Three-quarters of this growth would come from meeting intra-African demand and substituting imports of manufactured goods, which are much higher than in other emerging economies. The remaining one-quarter of the opportunity can come from accelerating growth in niche manufacturing exports.

Exhibit 30

Africa has an opportunity to triple historical manufacturing output growth rates, and to double output, in ten years



NOTE. Numbers may not sum due to rounding.

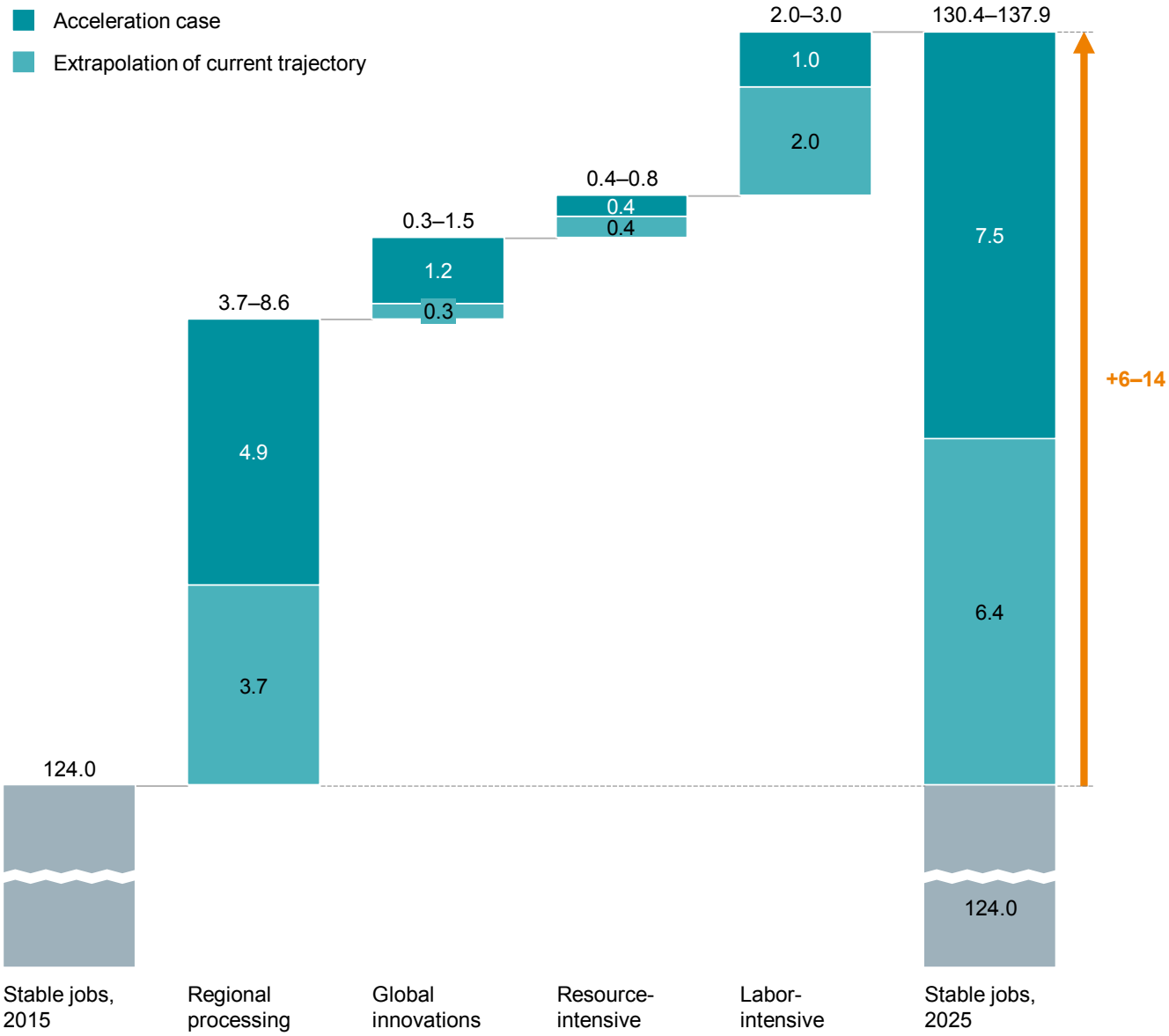
SOURCE: IHS; UNCTAD; McKinsey Global Institute analysis

A doubling of Africa's manufacturing output would, by our estimates, result in the creation of six million to 14 million stable jobs directly in the sector over the next decade, an increase of 5 to 11 percent over today's levels of stable jobs (Exhibit 31). The largest potential contributors to direct job creation would be industries in regional processing and labor-intensive tradables.[74]

Exhibit 31

African manufacturing could create 6 million to 14 million more stable jobs by 2025—an increase of 5 to 11 percent

Incremental impact on stable jobs from manufacturing growth
Million adults



NOTE: Numbers may not sum due to rounding.

SOURCE: IHS; UNCTAD; ILO; McKinsey Global Institute analysis

[74] This range is broad because it reflects the job creation potential of the business-as-usual case in the lower estimate and the acceleration case in the upper estimate. See next footnote for information on the two cases.

The largest opportunity to increase manufacturing output is in the global innovations category, which includes automotive and chemicals. In an "acceleration" case, we estimate that a select group of African manufacturers with existing hubs in this category could earn an additional $209 billion in annual revenue by 2025, six times what they would achieve at historical growth rates.[75] Reflecting the continent's growing population and rising household incomes, manufacturing of regional processing goods such as food and beverages is a second major opportunity. In this category, we estimate that local manufacturers could increase their revenue by as much as $122 billion by 2025, almost triple the expected growth on the current trajectory. Resource-intensive manufacturing (notably cement and petroleum products) and labor-intensive goods (such as apparel and footwear) are smaller but still significant opportunities; in these categories, African manufacturers could double their revenue growth over the next decade.

THREE-QUARTERS OF THE OPPORTUNITY CAN COME FROM MEETING SOARING DOMESTIC DEMAND FOR MANUFACTURED GOODS

Africa's consumer and B2B markets are growing fast, as we have discussed, and there is rising demand for a wide range of manufactured goods, including processed food and beverages, apparel, appliances, cars and trucks, fuel, construction materials, and industrial inputs. Given these trends, we estimate that African manufacturers could more than double their supply to intra-African markets by 2025, increasing their annual revenue by $326 billion.[76]

Foreign manufacturers have high market shares in categories that could be produced and supplied more easily and more cheaply in Africa.

$326B
increase in annual revenue by 2025 possible for African manufacturers targeting domestic markets

In some key industries and countries, there is a huge opportunity to produce domestically goods that are currently imported. Foreign manufacturers have high market shares in categories that could be produced and supplied more easily and more cheaply in Africa.[77] For example, Africa imports one-third of the food, beverages, and other similar processed goods it consumes. In comparison, the member states of the Association of Southeast Asian Nations (ASEAN) import approximately 20 percent of such goods, and the Latin American countries in the Mercosur trade bloc import about 10 percent of those goods (Exhibit 32).[78] About 60 percent of Africa's supply of global innovation goods are imported, double the share in Mercosur. Even in the case of cement—a resource-intensive sector with abundant local raw materials—Africa imports 15 percent of its needs, compared with about 5 percent in ASEAN and Mercosur.[79] In all these categories, African manufacturers can, and should, target significantly higher levels of local supply.

[75] For each category of manufacturing, we estimated the revenue for African manufacturers under a "business-as-usual" case and an "acceleration" case. The business-as-usual case is estimated based on Africa's historical market share of each type of manufactured good times the potential market size in 2025, while the acceleration case is based on the assumption that African manufacturers could increase their market share to the benchmarked potential for each category.

[76] The upper range of the output growth in the domestic demand opportunity is broken down as follows: regional processing, $122 billion; global innovations, $134 billion; resource-intensive manufacturing, $56 billion; and labor-intensive tradables, $14 billion. Labor-intensive tradables is discussed under the export opportunity.

[77] Countries should be wary of making import substitution a broad primary aim of strategy and instead judge whether the case for substitution is made on the basis of a detailed understanding of productivity and competitiveness in domestic sectors. See Chapter 5 for further discussion on this point.

[78] ASEAN consists of Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam. Mercosur comprises the economies of Argentina, Brazil, Paraguay, Uruguay, and Venezuela.

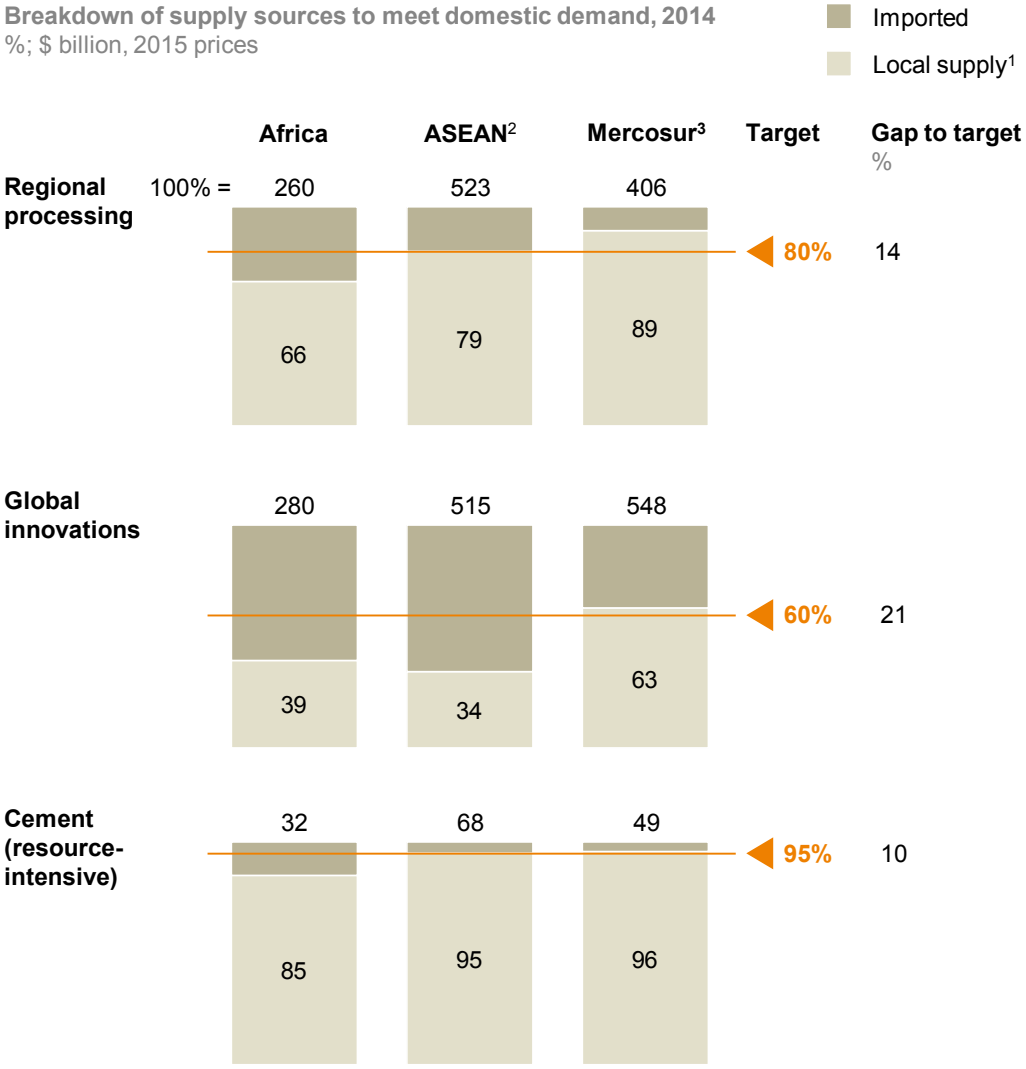
[79] On a tonnes basis.

The categories with the greatest potential for growth are regional processing (particularly food and beverages) and global innovations (mainly machinery, automotive, and chemicals). There is also a sizable opportunity to increase Africa's manufacture of cement and petroleum products, both resource-intensive sectors.

Exhibit 32

Africa imports a large share of products that could be manufactured within the region

Breakdown of supply sources to meet domestic demand, 2014
%; $ billion, 2015 prices



1 Includes domestic output and intraregional trade.
2 The Association of Southeast Asian Nations comprises Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam.
3 The Mercosur trade bloc comprises Argentina, Brazil, Paraguay, Uruguay, and Venezuela.
NOTE: Numbers may not sum due to rounding.

SOURCE: UNCTAD; WITS-UN Comtrade; *International Cement Review*; IHS; IMF; McKinsey Global Institute analysis

Regional processing: Feeding Africa's people and supplying its growing cities

As Africa's population grows, incomes rise, and cities expand, the demand for regional processing goods is increasing steadily. An analysis by IHS World Industry Service of nine major African markets found that demand for such goods grew at an average annual rate of 3.4 percent between 2000 and 2015.[80] Output of such goods in these countries grew at 3 percent a year, thereby failing to keep pace with rising demand. Africa still imports a large share of products in this category that could be manufactured within the region.

[80] The nine countries were Cameroon, Egypt, Kenya, Morocco, Nigeria, Senegal, South Africa, Tunisia, and Zimbabwe.

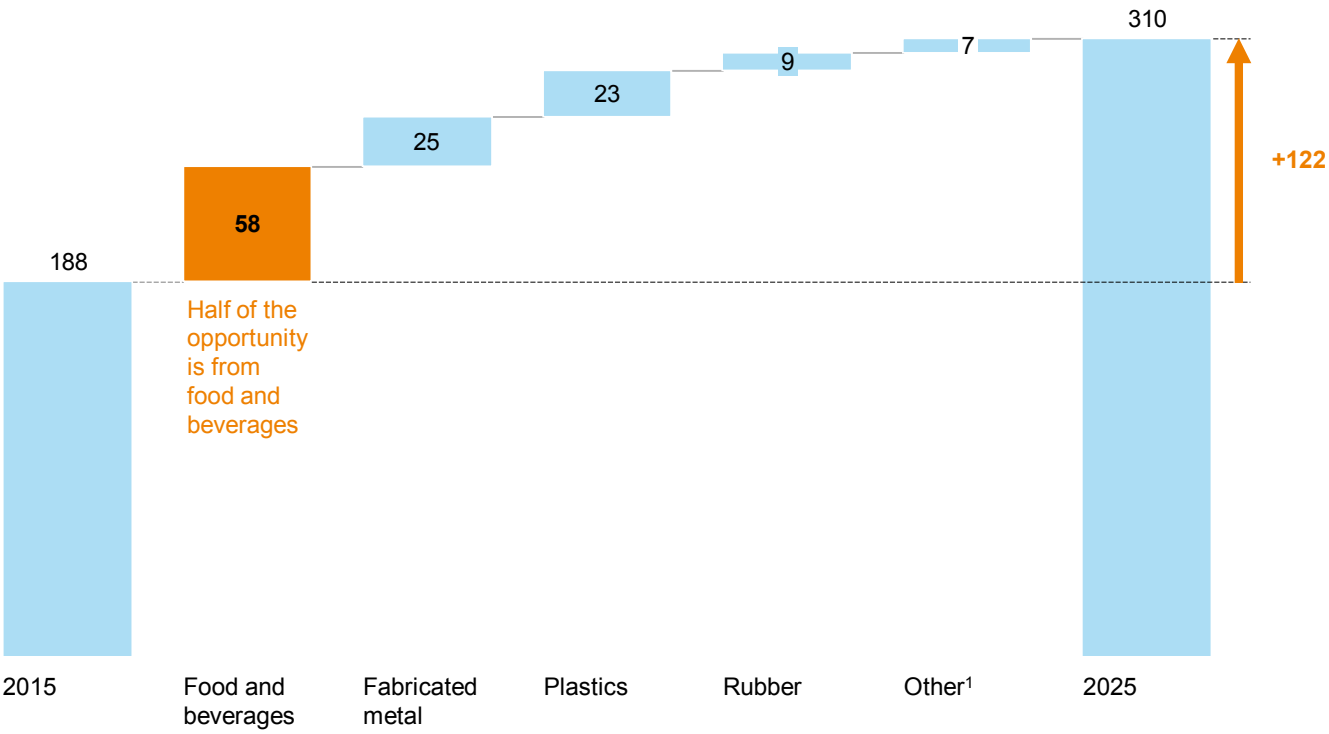
Boosting African supply of regional processing goods from 66 percent of local demand to 80 percent would increase output by two-thirds to $310 billion a year; food and beverages account for half of this opportunity (Exhibit 33). Other major growth categories include fabricated metal and plastics. Altogether, there is scope to create between four million and nine million new, permanent manufacturing jobs in regional processing across Africa by 2025.

The recent experience of some African countries shows that a major acceleration of regional processing production is possible. For example, Egypt and Nigeria each increased their value added from food manufacturing by around 9 percent a year between 2004 and 2014. Nigeria increased value added from fabricated metal manufacturing at an even faster pace over this period.

Exhibit 33

In regional processing, supplying 80 percent of Africa's demand by 2025 is a $122 billion manufacturing opportunity

African regional processing revenue projection to 2025, acceleration case
$ billion, 2015 prices



1 Includes printing and publishing, tobacco, and recycling.
NOTE: Numbers may not sum due to rounding.

SOURCE: IHS; McKinsey Global Institute analysis

Global innovations: Priming the engine of Africa's development

As Africans' incomes rise, vehicle ownership has been increasing rapidly. Across the continent, the number of vehicles on the road almost doubled over the past decade to reach 32 million in 2015. And as the business sector expands, demand for inputs such as machinery and chemicals is increasing fast. That makes the manufacture of global innovations a significant opportunity—although that opportunity is mostly confined to countries with existing manufacturing hubs.

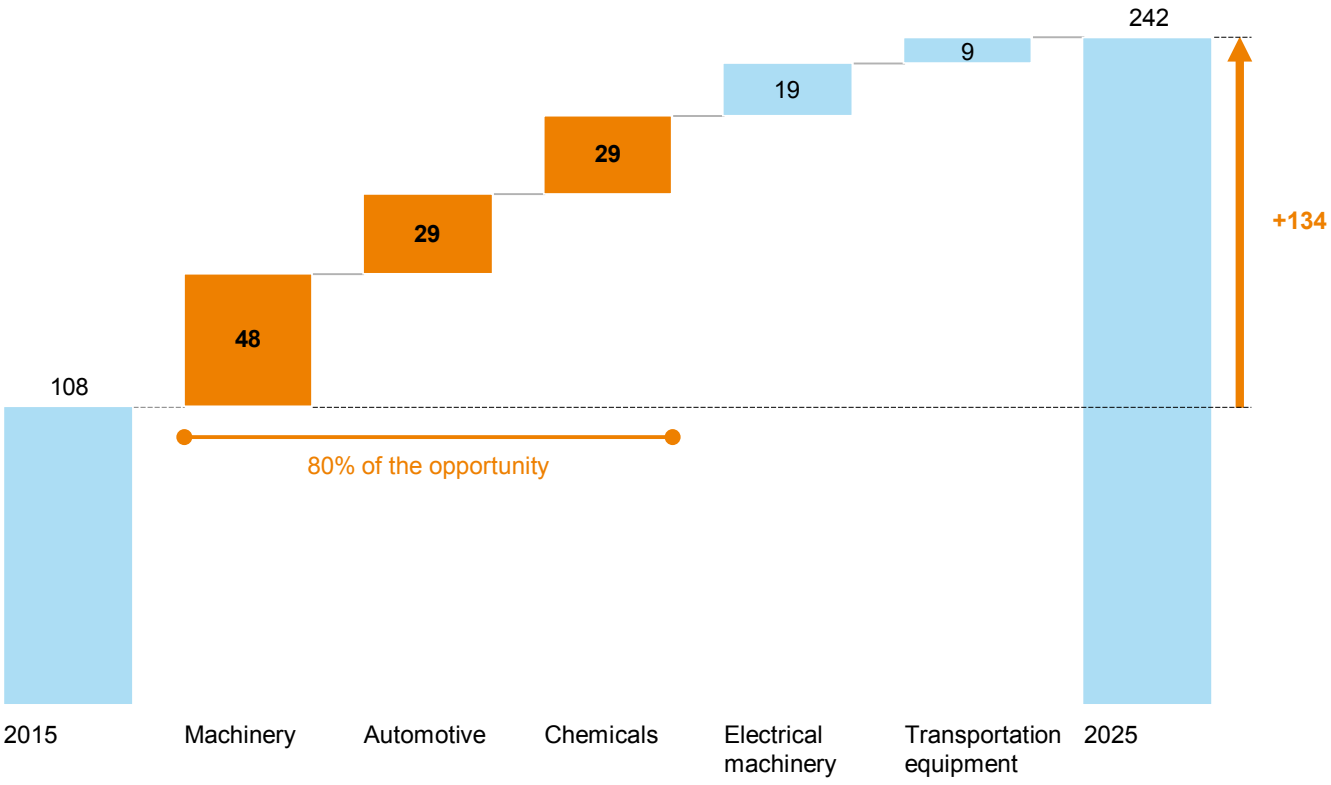
Over the past ten years, Africa's manufacturers have significantly expanded their capacity in automotive, machinery, and other sectors of global innovations. Egypt and Morocco increased revenue from automotive by around 10 percent a year in real terms between 2004 and 2014. While South Africa's larger automotive sector grew more slowly, it still added nearly $5 billion in incremental revenue over that period. South Africa's chemicals sector added more than $6 billion in incremental revenue.

However, these increases in production have not come close to meeting demand. African manufacturers today supply only 39 percent of local demand for global innovation products. If they were to increase that figure to roughly the level currently achieved by Mercosur—they would nearly double output to $242 billion by 2025 and accelerate growth in this category to 8 percent a year. Four-fifths of the growth opportunity lies in the automotive, chemicals, and machinery sectors (all categories that also have export potential) (Exhibit 34).

Exhibit 34

In global innovations, 80 percent of domestic growth potential lies in automotive, chemicals, and machinery

African global innovations revenue from sales within Africa projection to 2025, acceleration case
$ billion, 2015 prices



NOTE: Numbers may not sum due to rounding.

SOURCE: IHS; McKinsey Global Institute analysis

The opportunity in global innovations is largely focused on established manufacturing nations such as Egypt, Morocco, South Africa, and Tunisia, each of which has relevant skills in place and is well positioned in global value chains. Several other African economies have small bases in this category, with the potential to grow quickly in particular sectors. For instance, Nigeria has opportunities in chemicals and transportation equipment, Kenya in chemicals, Namibia in transportation equipment, and Zambia in chemicals and machinery.

For nations with established manufacturing hubs, a key growth opportunity lies in moving along the value chain in existing sectors to manufacture adjacent products. Automotive is a case in point. While Africa has significantly expanded its vehicle assembly capacity, its vehicle parts industry remains very small and a large share of parts is still imported. In contrast, parts manufacturing in China has grown in parallel with vehicle assembly, and the value of exports in both is quite similar. African countries could boost their own production of automotive components but need to analyze carefully which components they can produce profitably. There is also an opportunity for Africa's chemicals manufacturers to move into the production of chemical derivatives—a smaller share of the chemicals sector's output than in either China or India.

Africa's stock of housing, commercial buildings, and infrastructure is expanding steadily, and driving growth in demand for construction material such as cement, metals, and wood.

19%
average annual increase in African petroleum products imports, 2004–14

Resource-intensive manufacturing: The building blocks of Africa's growth

Africa's stock of housing, commercial buildings, and infrastructure is expanding steadily, as we have noted, and driving growth in demand for construction materials such as cement, metals, and wood. Africa has an abundance of the raw materials for all these commodities, but it still imports a large share of manufactured products, including 15 percent of its cement needs. Africa's demand for petroleum products has also increased at a steady rate as vehicle ownership has risen. Yet despite the continent's large-scale oil production, local refining capacity has not kept up with demand, and imports of petroleum products increased by an average of 19 percent a year from 2004 to 2014.

By meeting growing domestic demand and substituting imports, Africa could add $56 billion to its resource-intensive manufacturing output by 2025, according to MGI estimates.[81] Cement and petroleum products, which together account for two-thirds of production in the sector, are the biggest opportunities (although they differ substantially in their tradability) but there is also scope in smaller sectors such pulp and paper, and ferrous and non-ferrous metals.

There is an obvious opportunity to produce cement in Africa rather than importing it, given that the product is bulky and expensive to transportation. However, African manufacturers will need to raise the investment needed for a major capital expansion and achieve sufficient productivity levels to be internationally competitive; the continent currently has a mixture of newer, more competitive production facilities and older facilities with dated technology. Our analysis indicates that there is a much greater opportunity to expand production capacity than plans currently in place would indicate, as well as an opportunity to reduce the relatively

[81] We estimate there is also an export opportunity to markets outside Africa of up to $16 billion in intermediate processed goods including refined oil, processed metals, and wood. Together these add up to $72 billion.

high level of material imported from outside the continent.[82] Nigeria-based Dangote, one of Africa's largest cement producers, plans to increase its production capacity from 41 million tons in 2015 to 77 million tons by 2019.[83] A further 14 million tons in additional capacity have been announced by other companies by 2020.[84] However, these published plans amount to annual growth in Africa's capacity to produce cement production of only 1.8 percent a year in the period to 2020, 40 percent of the growth rate we believe is possible in our acceleration case.[85]

Despite the continent's large-scale oil production, local refining capacity has not kept up with demand.

In contrast to cement, petroleum is a globally traded good. The refining industry is also characterized by thin margins. Capacity has grown faster than demand in some international markets, which has resulted in regional product-supply mismatches. Overall, this sector is experiencing increased global trade intensity that could last for another decade.[86] In 2015, there were 49 refineries operating across Africa, but very little new capacity is expected to come onstream. Only one new refinery, in Lagos, Nigeria, is expected to be completed by 2025 despite a number of other announcements.[87] Capacity will also increase with investment in existing refineries in North Africa and South Africa. Overall, the continent's refining capacity is projected to grow by only 23 percent over the next decade, reflecting the challenge of building competitive refineries in Africa. Nevertheless, even this new capacity could raise output by up to 40 percent and be worth an incremental $21 billion to $41 billion depending on the path of oil prices.[88]

THE OTHER ONE-QUARTER OF THE OPPORTUNITY CAN COME FROM EXPANDING EXPORTS OF LABOR-INTENSIVE AND GLOBAL INNOVATIONS GOODS

Exports are another promising opportunity for Africa's manufacturers. In our acceleration case, MGI estimates that they could increase their export revenue by more than $100 billion by 2025. Three-quarters of this would come from exports in the global innovations category. But there is also an opportunity to export labor-intensive goods, a topic that is being actively discussed within Africa.[89]

82 Interviews highlighted that, despite cement typically experiencing very little global trade, the industry was enjoying relatively low shipping and energy costs. At the time of writing, this was encouraging cement manufacturers in some countries to export excess plant capacity at their marginal cost into the international market.

83 MGI interview.

84 *International Cement Review* database, June 2016; Global Cement database, June 2016; annual report, Dangote Cement, 2014.

85 These data sources indicate production overcapacity in some African markets, so utilization may increase instead.

86 McKinsey & Company Energy Insights.

87 Angola has announced its intention to build a 0.2 million barrels per day refinery, but the project has repeatedly been delayed and is not included in our estimates.

88 This range is based on a base price of $52 per barrel at the time of writing and an upside opportunity based on a consensus forecast from McKinsey Energy Insights of $70 per barrel in 2015 prices. The analysis is highly sensitive to assumptions about the price of oil.

89 The World Bank has highlighted this type of manufacturing as a particularly exciting and viable opportunity for Africa, especially given increasing costs and regulatory complexity in China. See Hinh T. Dinh et al., *Light manufacturing in Africa: Targeted policies to enhance private investment and create jobs*, Africa Development Forum, World Bank, 2012.

Global innovations: Quadrupling Africa's exports

In addition to producing more global innovations categories domestically, as discussed, African manufacturers have scope to build globally competitive export hubs in several of the region's countries and potentially quadruple their exports in just ten years.

7/10
top markets for African exports of global innovations are in Europe

MGI analyzed the top ten markets by sales for African exports of global innovations. Seven are in Europe, the largest of these being France, which imported $4.8 billion from Africa in 2014, and Germany, which imported $3.0 billion. The other three are Brazil, India, and the United States. On average, African manufacturers command a 1.5 percent share of exports to these ten countries, but the average disguises even smaller percentages in some cases: 0.2 percent in India, 0.3 percent in the United States, and 0.8 percent in the United Kingdom.[90] If Africa could lift its share to at least 2.2 percent in all ten of these markets, the highest quartile of its market share, it would add an incremental $75 billion to revenue from exports of global innovation categories. Morocco's success in increasing automotive and other exports over the past decade suggests some of the approaches that other African countries could emulate (see Box 3, "How Morocco has turbocharged automotive exports").

[90] *UNCTAD: Fostering Africa's services trade for sustainable development*, Special edition for the Third International Conference on Financing for Development, United Nations, 2015; UNCTADstat database: Trade structure by partner, product, or service-category (Merchandise: Trade Matrix by products, exports in thousands of dollars, annual, 1995–2014).

Box 3. How Morocco has turbocharged automotive exports

Over the past decade, Morocco has explicitly pursued a strategy to accelerate export-led growth of the global innovations category of manufacturing goods. As a result, its automotive industry multiplied its export revenue by a factor of 12, from $0.4 billion in 2004 to $5 billion in 2015, an annual growth rate of 26 percent. Tangier, Morocco's largest automotive manufacturing hub, has created jobs three times as fast as the country as a whole; in total, the automotive sector alone added 67,000 jobs between 2004 and 2015.[1] The country has attracted French automakers Renault and Peugeot, which together have invested more than $2 billion to create assembly capacity for 650,000 cars and 200,000 engines a year. Morocco has also attracted an ecosystem of global automotive suppliers including Delphi, Linamar, and Simoldes. It has also achieved notable export-led growth in other segments such as aerospace, which today employs more than 11,000 people.

Morocco has two distinct advantages: its proximity to large European markets, and labor costs that are substantially lower than in European countries. Morocco's government adopted the National Pact for Industrial Emergence in 2009, followed by the Industrial Acceleration Plan in 2014, to explicitly build on these advantages to power rapid industrialization. The cornerstone of these plans has been the creation of export-focused special economic zones supplied with top-quality infrastructure and located close to major ports. As a result, Morocco's position on the World Bank's global Logistics Performance Index improved from 94th place in 2007 to 50th place in 2012. Investors in Morocco's industrial sector have been offered significant fiscal incentives, including exemption from corporate tax for the first five years, and a flat tax rate of 8.75 percent for the next 20 years, as well as exemptions from customs duties and value-added tax on merchandise. The government has also announced a suite of incentives to encourage the emergence of an ecosystem of local players. To ensure that sufficient skills are available, Morocco has created sector-specific training centers and given employers direct financial aid for their own training programs.

[1] Z. Joe Kulenovic, *Tangier, Morocco: Success on the Strait of Gibraltar*, World Bank blog, 2015; *2014 investment climate statement—Morocco*, US Department of State, 2014; Ministry of Industry, Trade, Investment, and the Digital Economy, Morocco.

Labor-intensive manufacturing: Driving job creation and industrialization

Labor-intensive manufacturing is an opportunity for countries with traditionally small manufacturing bases to industrialize their economies, and it can also create significant numbers of jobs. Vietnam and Bangladesh added 3.7 million and 5.2 million manufacturing jobs, respectively, between 2000 and 2014, many of them related to labor-intensive exports. In Africa, we estimate that between two million and three million new, permanent manufacturing jobs could be created by 2025 if the full potential were to be achieved in this segment.

Labor-intensive manufacturing is an opportunity for countries with traditionally small manufacturing bases to industrialize their economies, and it can also create significant numbers of jobs.

Africa commanded only **1%** of global labor-intensive exports in 2014

Labor-intensive goods are not as high in value as other products, and therefore the opportunity to boost revenue growth is not as large as in other manufacturing sectors. But it is significant nonetheless. MGI estimates that African manufacturers of apparel, footwear, and other goods in this category could add up to $27 billion in revenue by 2025.

Global labor-intensive exports totaled $1.6 trillion in 2014, and Africa commanded just 1 percent of this total. In comparison, China has expanded its exports in this category by 14 percent a year over the past decade and now has an extraordinary 35 percent of the global total. Other Asian countries also achieved rapid growth. Vietnam's labor-intensive exports have grown at an annual rate of 18 percent (in nominal prices), those in Bangladesh at 14 percent, and India's at 11 percent. Africa increased exports in this category at only 3 percent a year. In our acceleration case to 2025, we see scope to raise that rate of annual growth to 7 percent, with nearly half of the opportunity coming from exports to countries outside Africa's borders.[91] We see three specific opportunities.

- **Leveraging lower labor costs.** China's rapid manufacturing growth was based in part on its low labor costs, but this advantage is fast eroding. Average Chinese hourly wages rose from $0.43 in 2000 to $2.88 in 2013, an annual increase of 16 percent.[92] This creates an opportunity for Africa. In many of the continent's low-income manufacturing nations, labor costs are closer to China's in 2000. Some countries have already translated this advantage into rapid growth in labor-intensive manufacturing exports. Tanzania, for instance, has achieved annual growth in such exports of 9 percent since 2004; Ethiopia's exports have grown at 12 percent a year (see Box 4, "Ethiopia's manufacturing success story").[93] Other countries can emulate this success, but they will need to move quickly because Bangladesh, Vietnam, and other lower-cost Asian nations are continuing their rapid manufacturing expansion. We note that low-cost production is not all about low labor costs but also about productivity improvements and enhancing competitiveness (see the discussion in the last section of this chapter).

[91] The continent already supplies 55 percent of its home markets in this category, comparable with other emerging economies, and therefore import substitution is a less compelling opportunity than in other segments.

[92] These wages are an average for the entire Chinese economy and are estimated from data on total wages plus benefits divided by total employment. The data come from the Global Growth Model of McKinsey & Company's Strategy & Trend Analysis Center.

[93] Michael Tobias Geiger and Lars Christian Moller, *Fourth Ethiopia economic update: Overcoming constraints in the manufacturing sector*, World Bank working paper number 97916, September 2015.

Box 4. Ethiopia's manufacturing success story

With more than 100 million people, Ethiopia is Africa's second-most populous country, but its per capita GDP has historically been among the continent's lowest. To accelerate broad-based growth, the government implemented two national five-year plans—the Plan for Accelerated and Sustained Development to End Poverty in 2005–10, and the Growth and Transformation Plan in 2010–15.[1] Industrialization was a key focus of both, and Ethiopia has increased its manufacturing value added by more than 10 percent a year since 2004 and become one of Africa's fastest-growing economies.

Ethiopia has taken a multipronged approach to creating a favorable environment for industry. First, it has strengthened key infrastructure, adding 66,000 kilometers of new roads since 2000 and increasing power supply by 15 percent between 2010 and 2014. At the time of writing, it was also building an electrified railway line between Addis Ababa, the capital, and the port in neighboring Djibouti.[2] Second, Ethiopia has developed industrial parks such as Bole Lemi in Addis Ababa, which already houses 12 manufacturing firms that export leather goods and apparel. Third, it has taken steps to improve its business environment, including waiving customs duty for the import of capital goods and setting up a one-stop shop to handle commercial registration, business licenses, and so on. Finally, Ethiopia has invested in expanding access to schooling, vocational training, and higher education.

Ethiopia's success has been based not simply on low labor costs, but also on unit labor costs that are competitive when productivity is taken into account. For example, its unit labor costs for the manufacture of polo shirts are $0.14 per unit, less than half the level in China and Vietnam. In the case of leather loafers, its unit labor costs are one-third those in Vietnam and one-fifth those of China.[3] As a result, the country has become a competitive global exporter of labor-intensive goods. For example, the value of its footwear exports has increased at an annual rate of 38 percent from 2004 to 2014, and the value of apparel exports at 22 percent a year over that period (Exhibit 35).

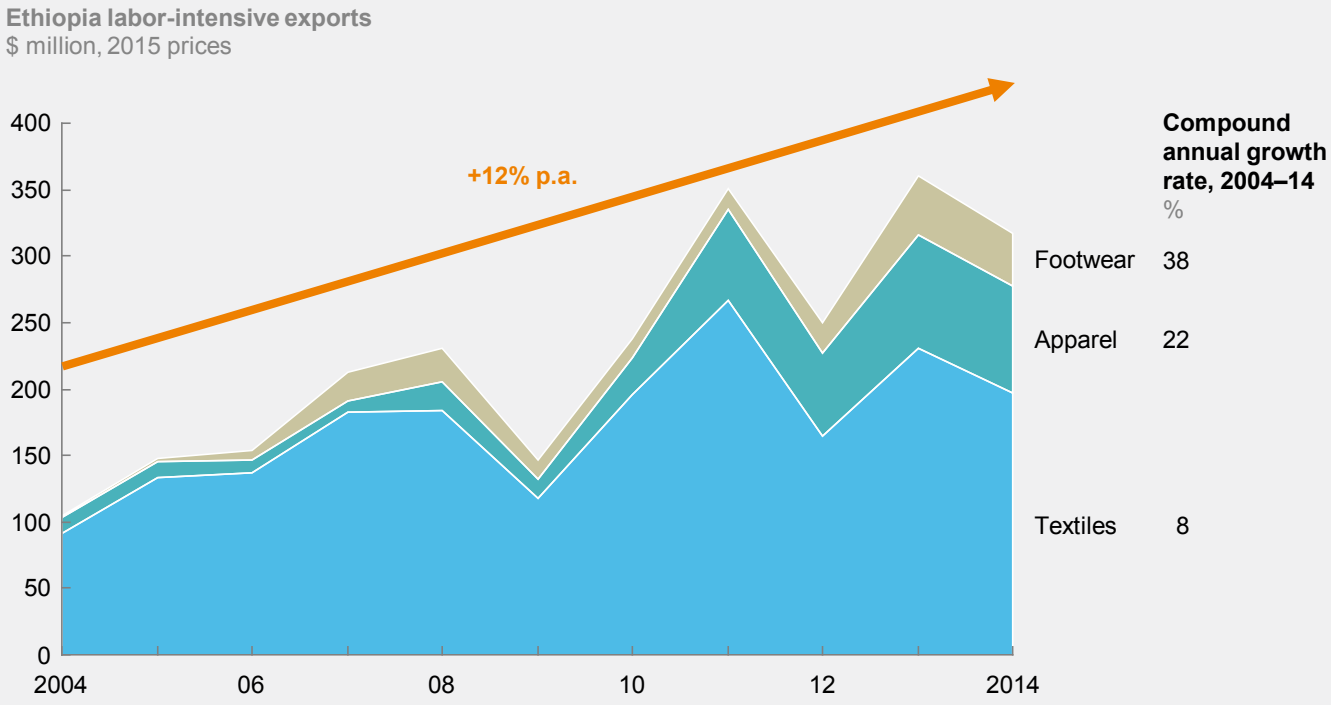
[1] A second Growth and Transformation Plan was launched in 2015, for the five years to 2020.

[2] Lars Christian Moller, *Ethiopia's great run: The growth acceleration and how to pace it*, World Bank working paper number 99399, November 2015.

[3] Hinh T. Dinh et al., *Light manufacturing in Africa: Targeted policies to enhance private investment and create jobs*, Africa Development Forum, World Bank, 2012.

Exhibit 35

In labor-intensive manufacturing, Ethiopia has significantly expanded exports



SOURCE: UNCTAD; Michael Tobias Geiger and Lars Christian Moller, *Fourth Ethiopia economic update: Overcoming constraints in the manufacturing sector*, World Bank, working paper number 97916, September 2015; McKinsey Global Institute analysis

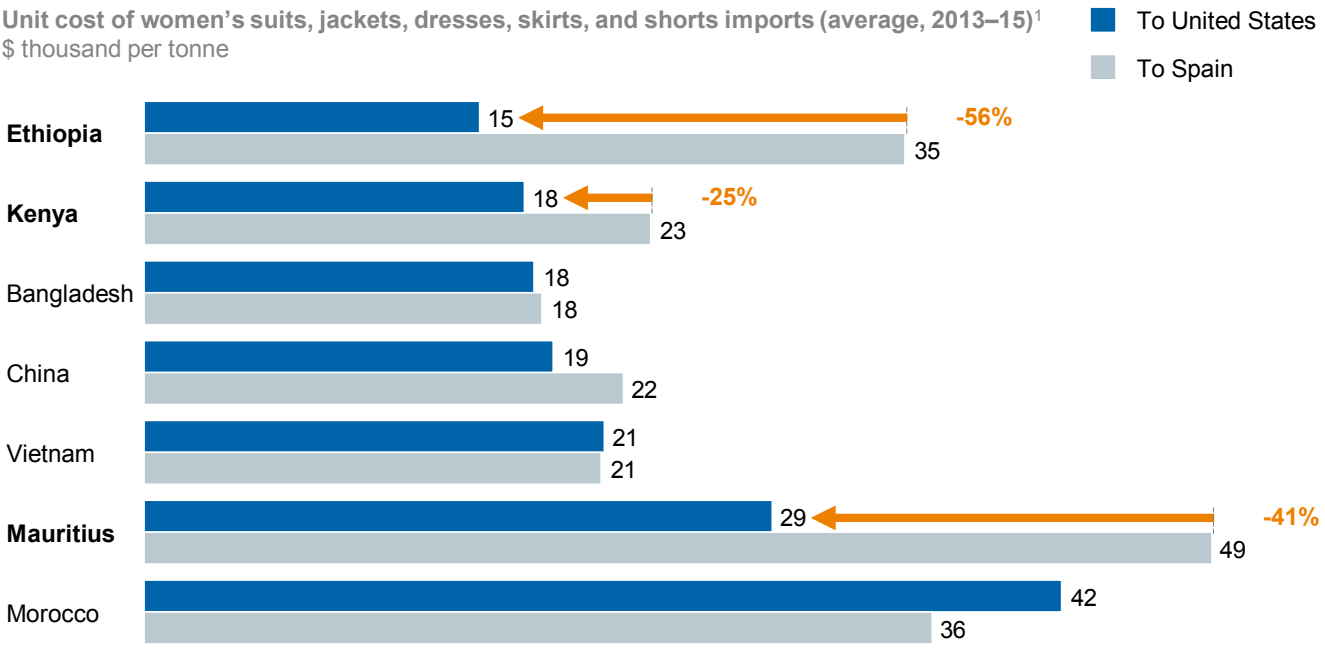
6%
a year decline in labor-intensive exports from Africa to the United States over the past decade

- **Taking advantage of proximity to Europe.** Countries in North Africa already have a strong base in labor-intensive manufactured goods, exporting nearly $11 billion in 2014, but they can do more to capitalize on their proximity to Europe's vast consumer markets to increase their exports of apparel and other labor-intensive goods. Egypt, for instance, has increased its exports by more than 10 percent a year since 2004. However, Morocco's exports in this category have barely grown over the past ten years (in contrast to that country's impressive performance in global innovation categories), and Tunisia's have declined in real terms. If Morocco and Tunisia could reach half the level of export growth of other North African countries, they would double their exports of labor-intensive goods within ten years.[94]

- **Increasing exports to the United States.** Manufacturers in sub-Saharan Africa have an opportunity to increase labor-intensive exports to the United States thanks to that country's African Growth and Opportunity Act. Introduced in 2000 and recently extended until 2025, AGOA provides exporters in some 40 sub-Saharan nations with tariff-free access to the United States, giving them a major cost advantage in thousands of product lines (in labor-intensive categories as well as others). In women's apparel, for example, AGOA makes Ethiopian and Kenyan goods sold in the United States 25 to 50 percent cheaper than in European markets—that gives these African countries a price advantage over the equivalent products imported from Bangladesh, China, or Vietnam (Exhibit 36). Yet Africa has not fully capitalized on this US initiative. Labor-intensive exports from Africa to the United States have declined by 6 percent a year over the past decade. This reinforces the conclusion that low labor costs alone are not enough to make African exports competitive—high costs in areas such as logistics and power are eroding Africa's advantage. AGOA is a precious opportunity for many African countries to expand output while simultaneously strengthening their competitiveness.

Exhibit 36

The AGOA trade agreement has made African exports to the United States much more competitive



1 Calculated by total import costs divided by total import volumes.
NOTE: Numbers may not sum due to rounding.

SOURCE: ITC Trademap; McKinsey Global Institute analysis

[94] This advantage also applies to other North African categories of manufacturing, particularly regional processing and global innovations.

Africa's manufacturing sector is much smaller than it could be. It serves a fraction of the continent's fast-growing domestic demand, and it has only scratched the surface of the international export opportunity. However, achieving its potential will be challenging. Governments have a broad and important role to play in enabling growth in African manufacturing, in concert with the private sector. In the next chapter, we turn to a discussion of corporate Africa and explore potential for greater private-sector dynamism to fuel the continent's growth, while in the final chapter we explore the role that governments could play in unlocking the manufacturing opportunity.

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4. THE RISE OF CORPORATE AFRICA

Africa is clearly ripe with business opportunities and is home to many fast-growing companies in a variety of sectors—not just resources, but also financial services, food and agri-processing, manufacturing, telecommunications, and retail. Yet compared with other emerging regions, we find that Africa is still heavily underrepresented in both the number and size of large companies. This matters because, in any economy, large firms are the primary drivers of growth, investment, corporate tax contributions, exports, and productivity.

What will it take for corporate Africa to achieve a dramatic step up in its scale, scope, and economic contribution? To answer this question, MGI built a comprehensive database of large companies operating in Africa that we believe is the first of its kind. The aim is to understand corporate Africa's business focus, growth patterns, and constraints. We have dissected the African economy to pinpoint the "white spaces" for growth in high-potential but fragmented sectors. We have also examined key success factors at work for the 100 African companies that have led the pack in terms of growth and profitability, which could be relevant to other businesses. Although governments can enable growth and private-sector dynamism on a broad front, Africa's companies should not wait for the perfect playing field to be in place. They need to go aggressively after the rich potential that exists.

Africa is still heavily underrepresented in both the number and size of large companies. This matters because, in any economy, large firms are the primary drivers of growth, investment, corporate tax contributions, exports, and productivity.

AFRICA HAS 400 COMPANIES WITH REVENUE OF $1 BILLION OR MORE, AND 700 WITH REVENUE OF AT LEAST $500 MILLION

Large companies are the primary drivers of growth. They contribute disproportionately to higher wages and taxes, as well as innovation and technology dissemination in industries as diverse as mining and pharmaceuticals. MGI estimates that the largest 100 companies by revenue across a number of countries in Africa contribute 50 to 60 percent of corporate taxes.[95] Large companies are also key drivers of productivity.[96] They are better able to attract capital, which means they are much more likely to compete on the global stage and hold their own against foreign entrants to their local economies. Large firms also foster sustainable small-business creation through the upstream and downstream ecosystems they help to create.

[95] Corporate tax payments by the largest 100 companies by revenue divided by total corporate tax collected at the national level. Sources include company annual reports, national statistics, and Capital IQ, July 2016.

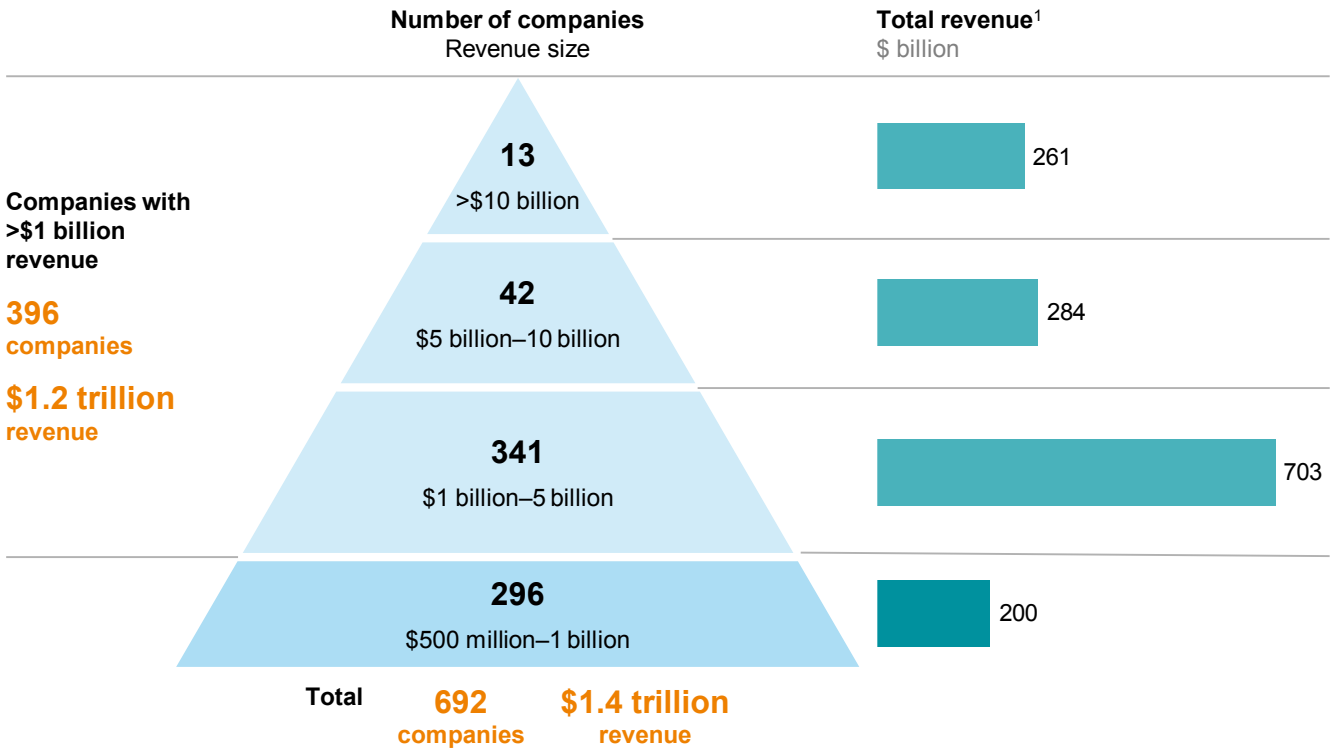
[96] OECD research, for instance, finds that, in many countries, companies with 250 employees or more are twice as productive as small and medium-sized enterprises and that in emerging economies such as Brazil large firms are three times as productive.

MGI's new database of the continent's large companies covers their geographical and sectoral focus, ownership, source of revenue, and historical growth. This analysis shows that Africa today is home to nearly 400 companies earning revenue of $1 billion or more, and to about 700 companies with revenue greater than $500 million (Exhibit 37). These companies together boast $1.4 trillion in annual revenue, are increasingly regional or pan-African, and in many cases are growing very fast. While resources remains the dominant corporate sector, 70 percent of large companies' revenue now comes from non-resources sectors (Exhibit 38). The emergence of successful African companies in sectors such as retail, financial services, and transportation services is indicative of the continent's progressive diversification.

Exhibit 37

Around 700 companies in Africa account for $1.4 trillion in revenue

Breakdown of companies by revenue size, April 2016



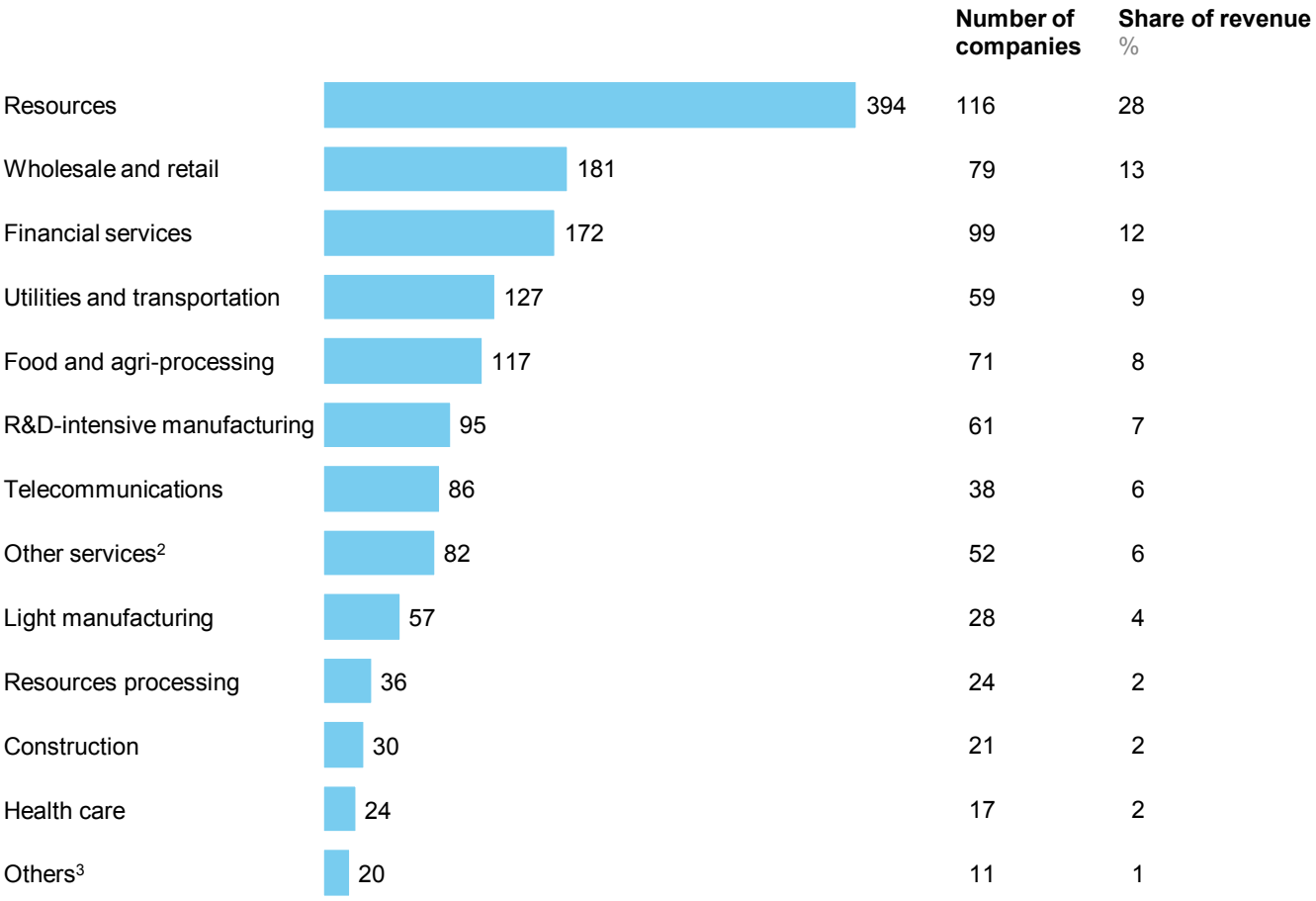
1 2014 or most recent data.

SOURCE: MGI African companies database; McKinsey Global Institute analysis

Exhibit 38

Resources is still the most important sector for large companies in Africa, accounting for ~30 percent of revenue

Revenue of African companies (>$500 million in revenue), 2012–14[1]
$ billion


Number of companies
Share of revenue %
Resources 394 116 28
Wholesale and retail 181 79 13
Financial services 172 99 12
Utilities and transportation 127 59 9
Food and agri-processing 117 71 8
R&D-intensive manufacturing 95 61 7
Telecommunications 86 38 6
Other services[2] 82 52 6
Light manufacturing 57 28 4
Resources processing 36 24 2
Construction 30 21 2
Health care 24 17 2
Others[3] 20 11 1

1 Most recent available revenue used.
2 Includes IT, real estate, media, and marketing.
3 Includes brokers/intermediaries, and restaurants.

SOURCE: MGI African companies database; McKinsey Global Institute analysis

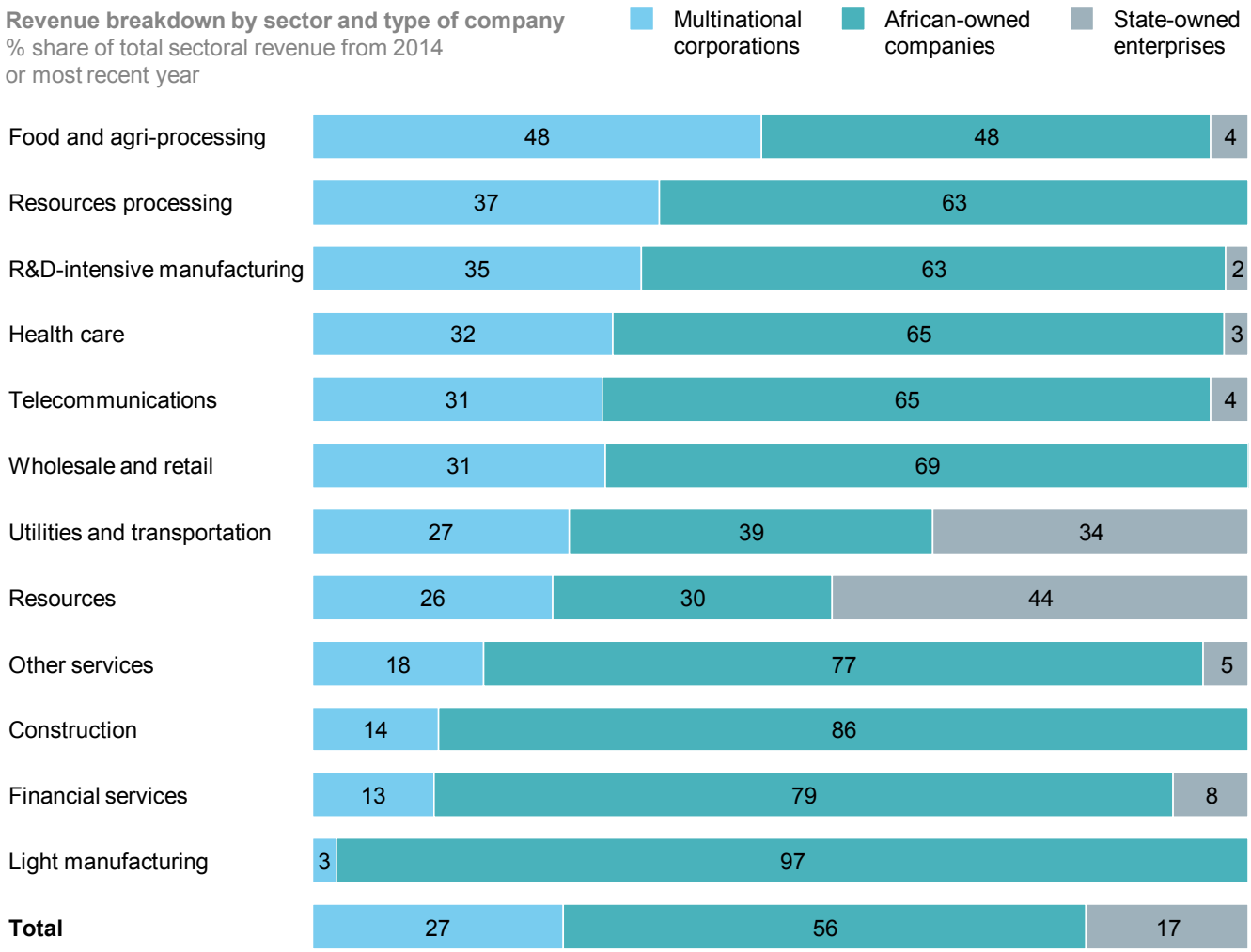
2/5
of Africa's 700 large companies are publicly listed

Africa's corporate landscape is more diversified than expected

Analysis of the ownership of Africa's large companies reveals a diverse picture. At the aggregate level, just over half the large firms operating in the continent are African-owned; 27 percent are foreign-based multinationals, half of which, interestingly, are headquartered in Europe and one-quarter in North America; and the remaining 17 percent are state-owned enterprises. This picture varies significantly by sector. For example, multinationals dominate in food and agri-processing, while state-owned enterprises play a much larger role in resources, utilities, and transportation (Exhibit 39). Of all 700 large companies, around two-fifths are publicly listed and the remainder are privately held (Exhibit 40). It is worth noting that Africa is underrepresented in family businesses, which we define as firms in which the founder or founding family members are still significant stakeholders or prevalent decision makers. Such family businesses make up only 10 to 20 percent by revenue of Africa's locally owned large firms compared with 50 to 60 percent in Latin America, 35 to 45 percent in Western Europe, and 15 to 25 percent in China and Southeast Asia. This suggests there is ample room for Africa's leading business families to raise their sights and play an increasingly significant role in driving economic growth.

Exhibit 39

Corporate Africa comprises mostly local companies, followed by multinational corporations and state-owned enterprises


Revenue breakdown by sector and type of company
% share of total sectoral revenue from 2014 or most recent year
Multinational corporations
African-owned companies
State-owned enterprises
Food and agri-processing 48 48 4
Resources processing 37 63
R&D-intensive manufacturing 35 63 2
Health care 32 65 3
Telecommunications 31 65 4
Wholesale and retail 31 69
Utilities and transportation 27 39 34
Resources 26 30 44
Other services 18 77 5
Construction 14 86
Financial services 13 79 8
Light manufacturing 3 97
Total 27 56 17

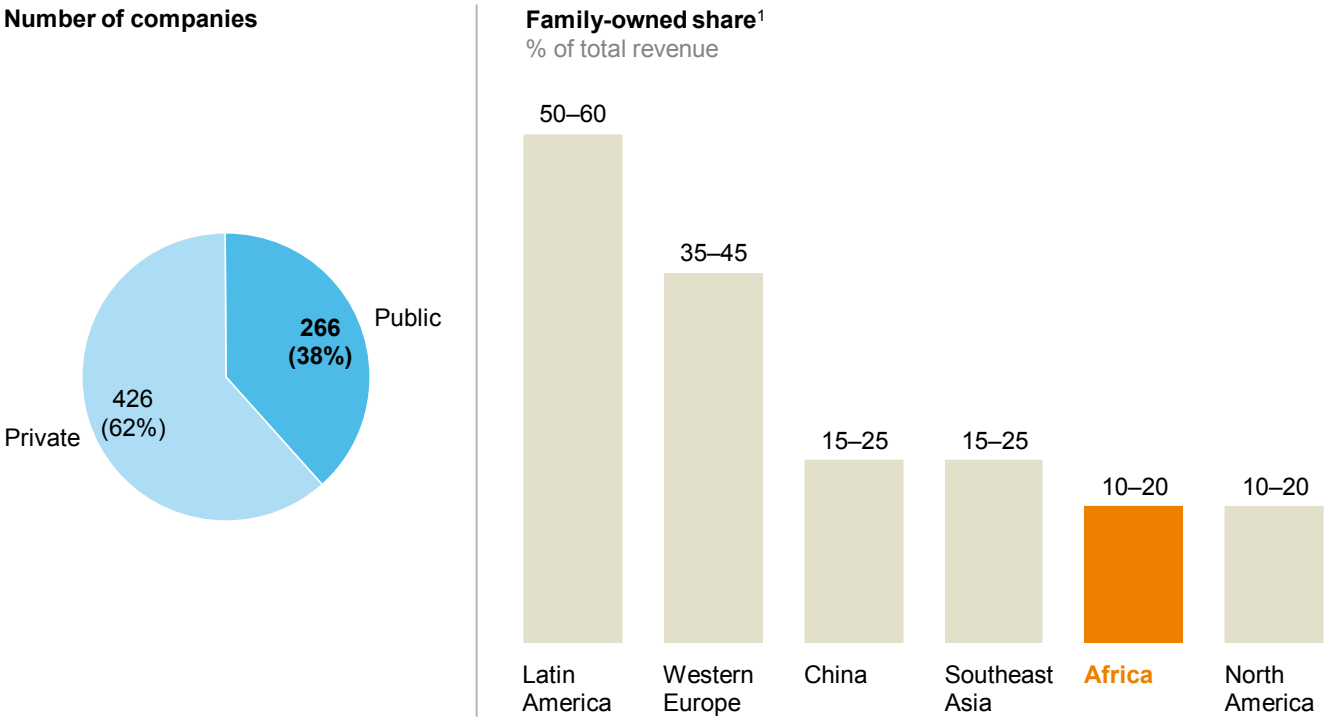
NOTE: Numbers may not sum due to rounding.

SOURCE: MGI African companies database; McKinsey Global Institute analysis

There is ample room for Africa's leading business families to raise their sights and play an increasingly significant role in driving economic growth.

Exhibit 40

Nearly forty percent of large African companies are public, and 10 to 20 percent are family owned



1 Analysis excludes multinational corporations from other regions but includes state-owned enterprises; analysis looks at companies whose founder or founding family members are still significant stakeholders or important decision makers.
NOTE: Numbers may not sum due to rounding.

SOURCE: MGI African companies database; *Playing to win: The new global competition for corporate profits*, McKinsey Global Institute, September 2015; McKinsey Global Institute analysis

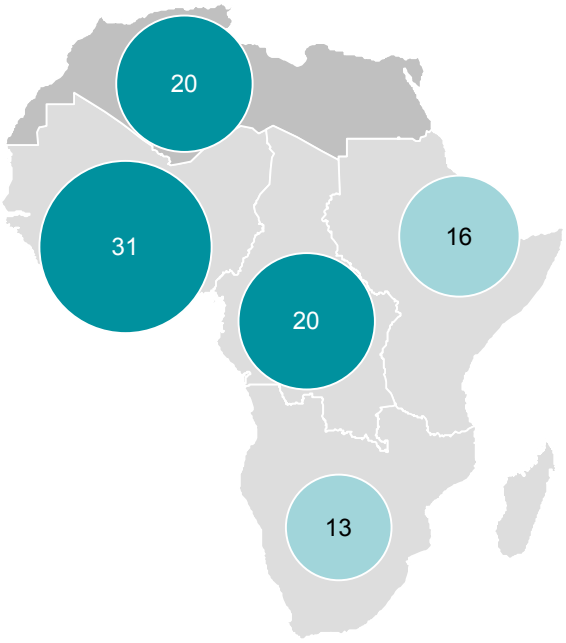
The geographic footprint of Africa's large companies correlates strongly with their ownership. Foreign-based multinationals, which in many cases have built up their presence in Africa over multiple decades, tend to be pan-African in their scope. By contrast, locally based private companies tend to expand mainly within their region of origin—large firms based in East, West, and Southern Africa earn more than half of their non-domestic revenue from their immediate regions where they enjoy geographic proximity or strong cultural ties (Exhibit 41). This regional focus limits their scale. State-owned enterprises are even narrower in their geographic scope—they tend to operate only in their home countries, and with their heavy focus on resources and utilities they are also less diversified than their peers in other emerging regions.

Exhibit 41

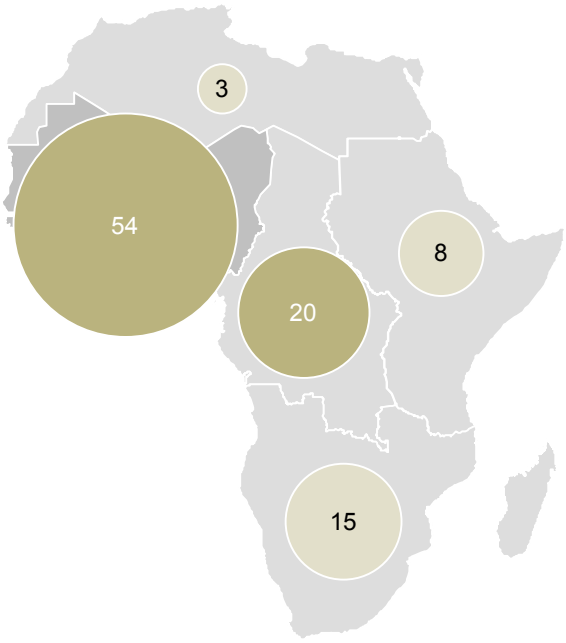
Local private companies first tend to expand in markets with strong regional or cultural ties

Where do African companies expand on the continent?
% of cases in which companies expand to a particular region (n = 53)[1]

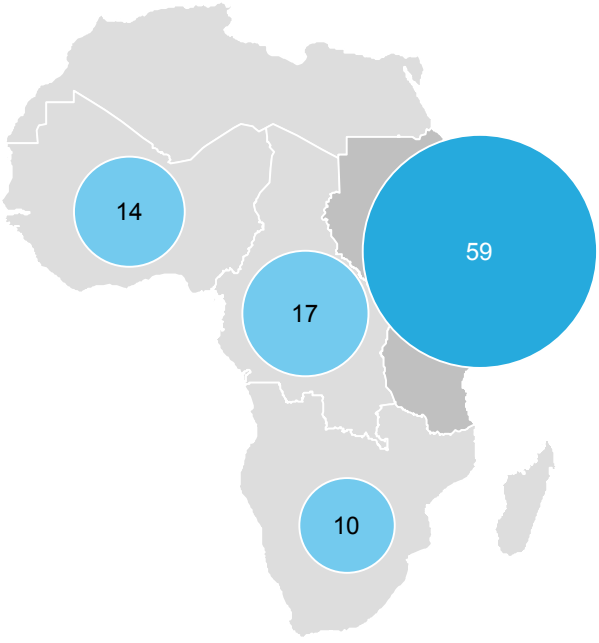
North African companies
West Africa, especially Francophone countries, is a priority for North African companies willing to expand



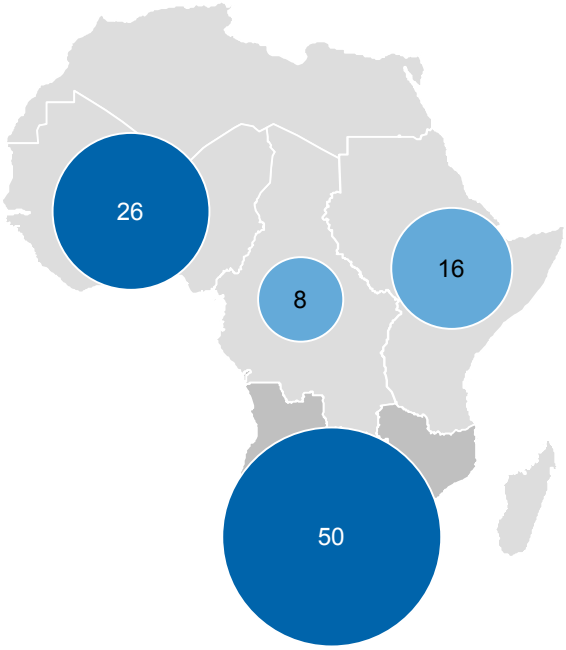
West African companies
West African companies tend to stay in their home region, with Nigeria being a preferred destination market



East African companies
East African companies tend to stay in their home region



Southern African companies
Southern African companies tend to stay in their region, with some expanding to other markets (primarily Kenya and Nigeria)



1 Figures excluding home country.
NOTE: Numbers may not sum due to rounding.

SOURCE: Company websites; McKinsey Global Institute analysis

African firms are faster growing and more profitable than the global average

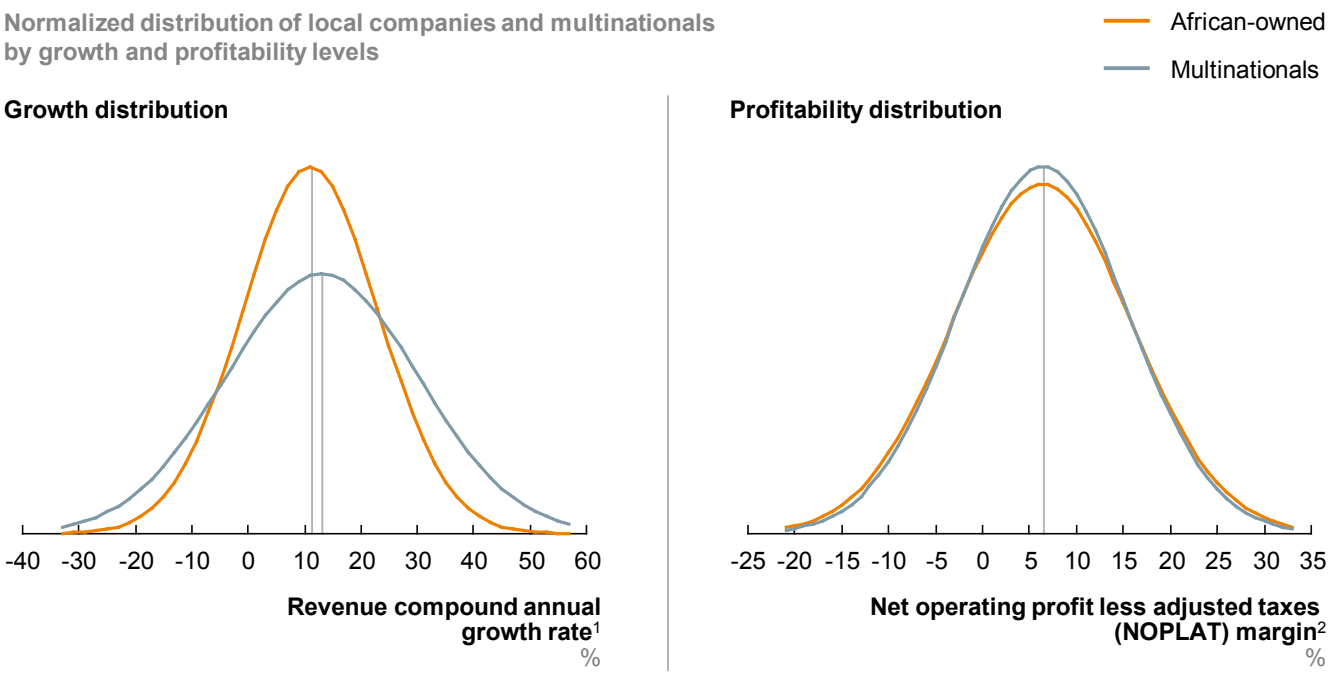
We assessed the growth potential of B2B markets in a range of sectors in Chapter 2. But which of these offer the most profitable growth opportunity for companies with ambitious African growth strategies? To answer this question, MGI undertook an in-depth scan of a dozen main economic sectors across the continent to understand the performance of large companies both in terms of their historical growth and their profitability.

First, we found that African-owned companies are as profitable as foreign-based multinationals operating on the continent and are growing equally fast (Exhibit 42). Then, we found that African companies in most sectors grew faster than their peers in the rest of the world in local currency terms, and they were more profitable than their global peers in most sectors (Exhibit 43).[97] Six sectors are particularly promising. In these sectors—wholesale and retail, food and agri-processing, health care, financial services, light manufacturing, and construction—large African companies were both more profitable and faster growing than global peers.[98] In addition, there appears to be significant potential for further growth given the fact that these six sectors today remain relatively fragmented: consolidation could unleash even more opportunity for corporate Africa.

Exhibit 42

African-owned companies tend to grow at a similar pace to multinational corporations, with comparable profitability

Normalized distribution of local companies and multinationals by growth and profitability levels


African-owned
Multinationals
Growth distribution
-40 -30 -20 -10 0 10 20 30 40 50 60
Revenue compound annual growth rate[1]
%
Profitability distribution
-25 -20 -15 -10 -5 0 5 10 15 20 25 30 35
Net operating profit less adjusted taxes (NOPLAT) margin[2]
%

1 Revenue compound annual growth rate 2008–15 (or most recent year), in local currency, from a sample of 211 companies.
2 Net operating profit less adjusted taxes as percent of total sales, 2015, from a sample of 120 companies.
NOTE: Because of gaps in data availability, analyses include only multinational corporations with a registered branch in Africa (~20).

SOURCE: MGI African companies database; McKinsey Global Institute analysis

97 The low profitability of utilities and transportation companies is primarily driven by airline companies that constitute 20 percent of that data set of ten companies.

98 Light manufacturing is a broad term that encompasses most manufactured goods that are typically labor-intensive tradables or regional processing goods. In this chapter, we define it to include all companies that manufacture construction products, consumer staples, light metal products, packaging, jewelry, and textiles. Processed food manufacturers are considered separately.

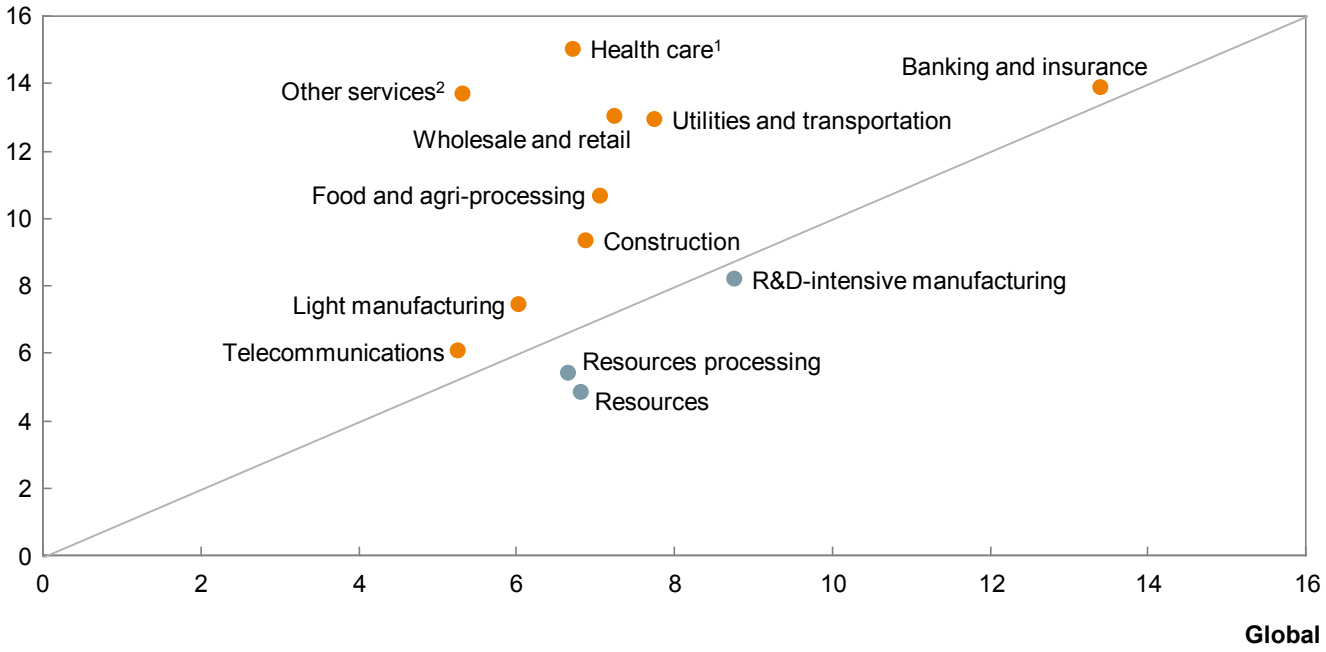
Exhibit 43

Large companies in Africa have tended to grow faster and have been more profitable than their global peers

Growth of African companies vs. rest of world by sector, 2008–14
Local currency basis
%

Growth relative to rest of world
Faster Slower

Africa

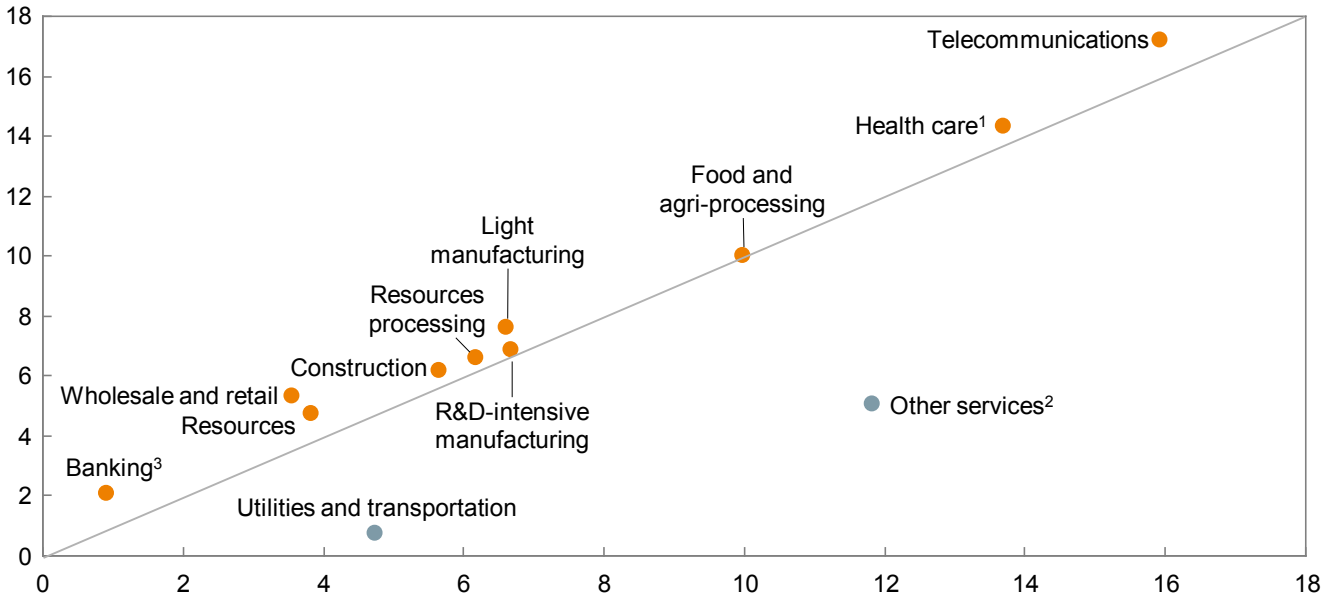


Global

Profitability of African companies vs. rest of world by sector, 2013–14
Net operating profit less adjusted taxes (NOPLAT) as % of revenue

Profitability relative to rest of world
Higher Lower

Africa



Global

1 n = 4 for health care due to sector size and data availability.
2 Other services includes information technology, media, real estate, marketing, and other business services.
3 Banking profitability measured by return on assets in percentage terms.

SOURCE: McKinsey Corporate Performance Analytics; McKinsey Global Banking Pools; McKinsey Global Institute analysis

We considered whether the level of consolidation in each sector created opportunities for growth by new companies, either through acquisitions or organic expansion. This analysis demonstrated, for instance, that telecommunications is already a highly consolidated industry in Africa. In the continent's largest economies, the top three telecommunications operators hold a combined market share of 95 percent or more. Banking shows a relatively high degree of consolidation in some markets—the top three local banks hold a combined market share of 84 percent in South Africa and 83 percent in Morocco. In other markets there is more open space in this sector. In Kenya, for instance, the top three local banks have a 57 percent market share; in Nigeria, the share is 45 percent. By contrast, the food and agri-processing sector is highly fragmented across the region with the top three firms holding a combined market share of 25 percent or less in nearly all the largest economies. Private health care is almost as fragmented as food and agri-processing, and the same goes for retail outside Kenya, Morocco, and South Africa.

While it is clear that African manufacturing has not yet achieved its full potential, light manufacturers that do succeed are profitable and growing; there is genuine potential for others to emulate their success.

Nearly
1/2
of Africa's large companies are in South Africa

This analysis yields several insights of relevance for companies seeking to expand or invest in multiple African countries. First, while companies in most sectors are growing and are profitable, companies in the six sectors identified stand out for being successful on an international level. Many of these sectors are tied to Africa's burgeoning consumer opportunity, meeting both basic needs such as processed foods, retail, and utilities, and increasing demand for discretionary spending (such as health care and retail banking services). While it is clear that African manufacturing has not yet achieved its full potential, light manufacturers that do succeed are profitable and growing; there is genuine potential for others to emulate their success. Finally, the construction sector offers promising opportunities given Africa's continued infrastructure rollout and rising demand for housing. In all six of the fast-growing, profitable sectors we have discussed, the size of the opportunity suggests that there is still space for many other companies to do well.

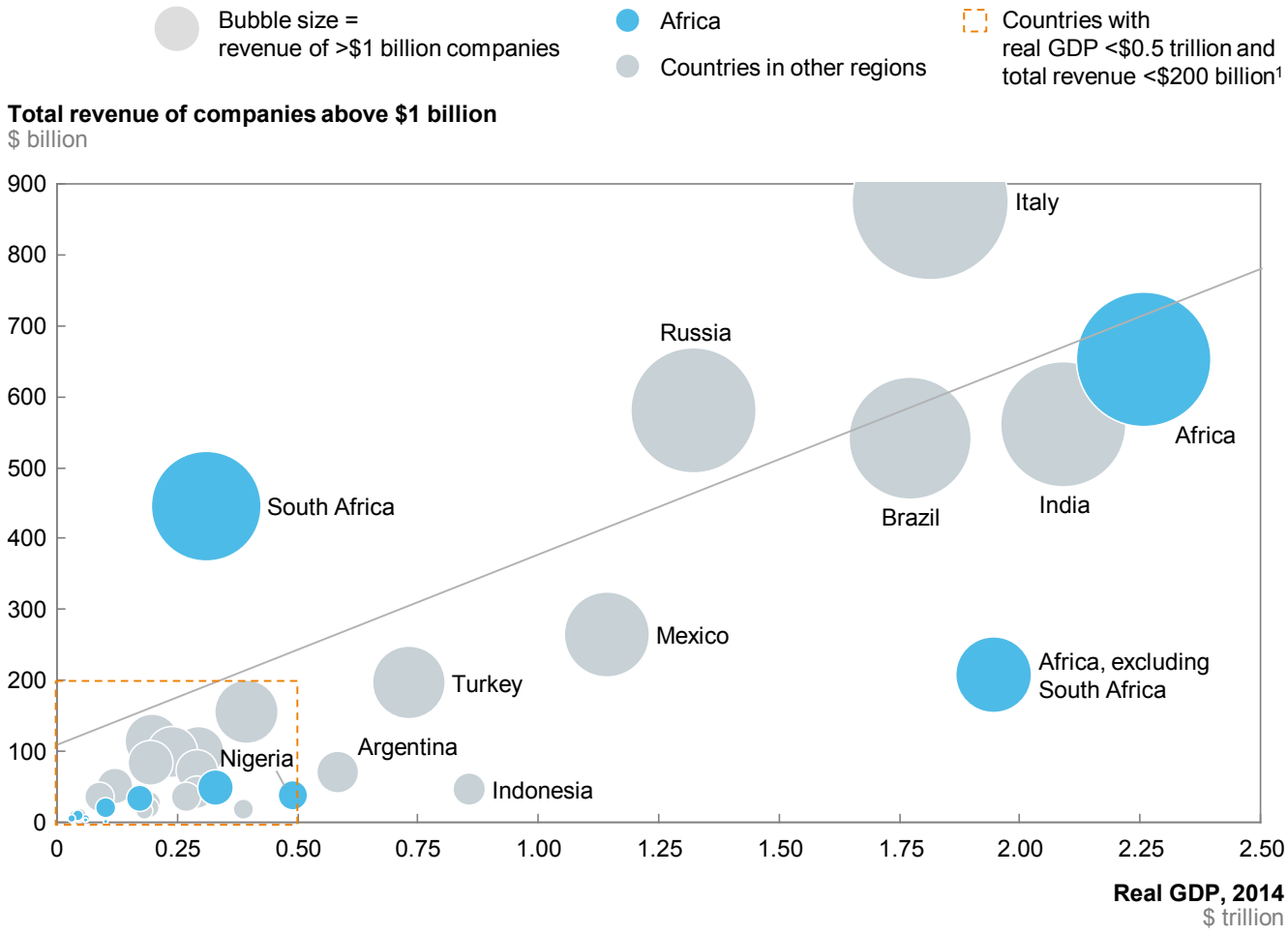
DESPITE THE SUCCESSES OF MANY LARGE AFRICAN COMPANIES, MORE BUSINESSES WITH GREATER SCALE AND REACH ARE NEEDED

Despite some notable corporate success stories, Africa as a whole lags behind other emerging regions in its prevalence of large companies. While total revenue earned by large companies across the continent appears to meet expectations, once South Africa is excluded the rest of the continent is underrepresented in the total revenue pool (Exhibit 44). In fact, excluding South Africa, the rest of Africa has just 60 percent of the number of large companies one would expect if it were on a par with peer regions.[99] Only in South Africa is there a globally comparable prevalence of large companies; its economy has 9.6 companies per $10 billion in revenue, compared with 1.9 in North Africa and 1.1 in Nigeria. Indeed, South Africa accounts for nearly half of all Africa's large companies (see Box 5, "Why is South Africa such an outlier?"). North African countries account for one-fifth of the continent's large companies. The rest of Africa has far too few large companies (Exhibit 45).

[99] Note that this analysis excludes state-owned enterprises and multinational corporations.

Exhibit 44

South Africa has a high concentration of large companies, but the rest of the continent is under-represented in the total revenue pool



1 African countries include Algeria, Angola, Côte d'Ivoire, Egypt, Ethiopia, Kenya, Morocco, Nigeria, and Tunisia. Countries in other regions include Chile, Colombia, Croatia, Czech Republic, Greece, Hungary, Iran, Jordan, Malaysia, Pakistan, Peru, Philippines, Portugal, Serbia, Thailand, Ukraine, and Vietnam.
NOTE: Analysis excludes multinational corporations and state-owned enterprises; China not shown due to scale considerations (578 large companies for a GDP of $10.8 trillion).

SOURCE: IHS; McKinsey Companyscope; MGI African companies database; McKinsey Global Institute analysis

Box 5. Why is South Africa such an outlier?

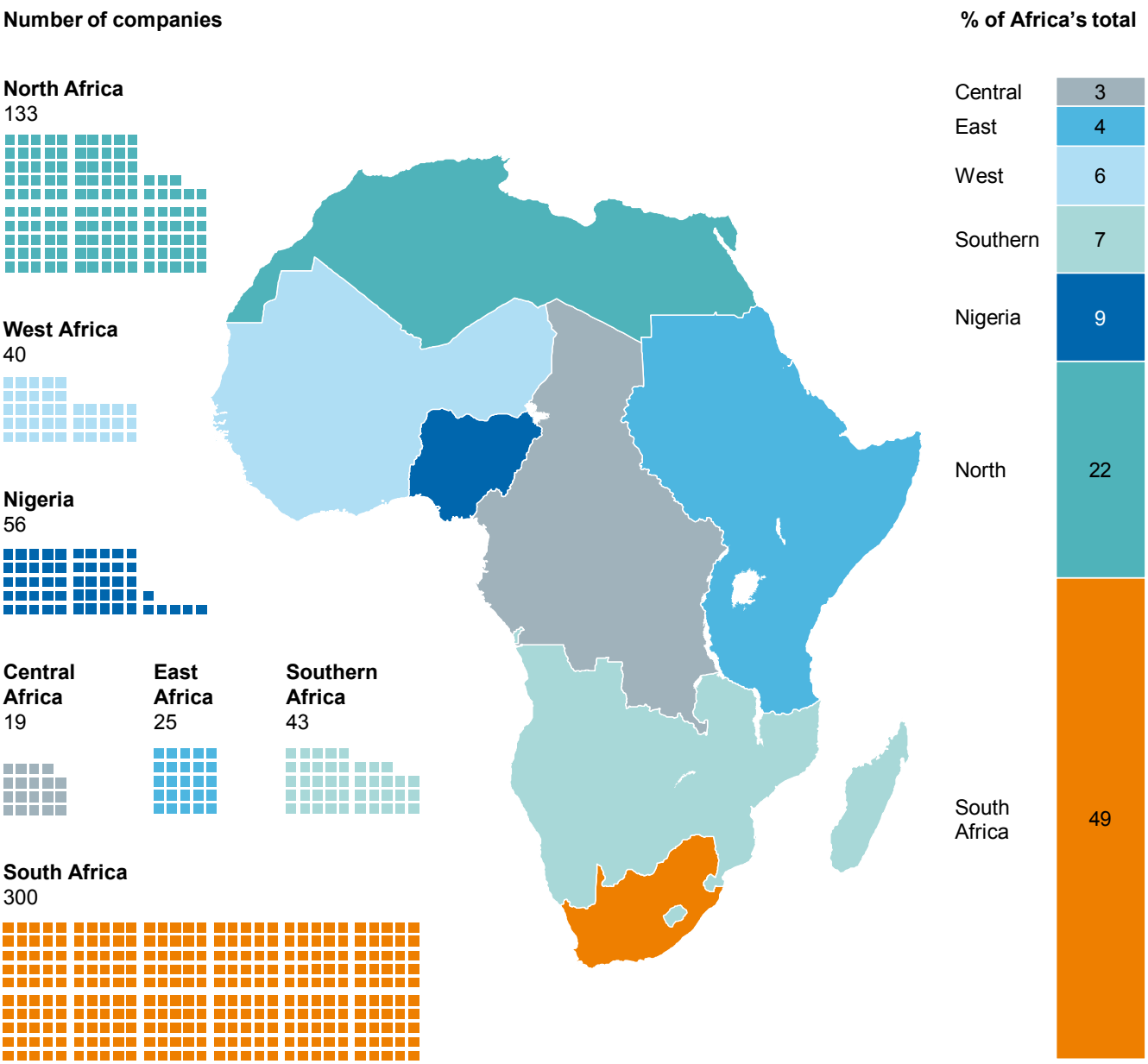
Home to almost half of Africa's large companies, South Africa is an outlier not just in its own continent but in the world. The reasons for this are largely historical. The country first became attractive to foreign investment and multinationals in the late 19th century when it was experiencing a resources boom. The industrialization that ensued, coupled with the development of basic infrastructure, enabled the growth of local players. During the apartheid years in the second half of the 20th century, South Africa's economy became increasingly isolated, as a result both of internal policies and international sanctions. This limited the cross-border expansion of the country's large firms and prompted the growth of large, diversified conglomerates focused on the domestic market.

Since the end of isolation and South Africa's democratic transition in 1994, a number of factors have driven the latest wave of corporate growth. These include the emergence of a significant consumer class as large numbers of households have entered the middle class; a continued high rate of infrastructure investment at around 5 percent of GDP; relatively strong institutions; and a robust business and economic ecosystem. Together, these factors have bolstered the growth of existing large companies and supported the emergence of large consumer companies. Several major South African firms have also taken advantage of the country's reintegration into world markets by building extensive businesses across Africa and beyond.

Exhibit 45

Large companies are disproportionately based in South Africa

Companies with more than $500 million in revenue, by region, 2014[1]



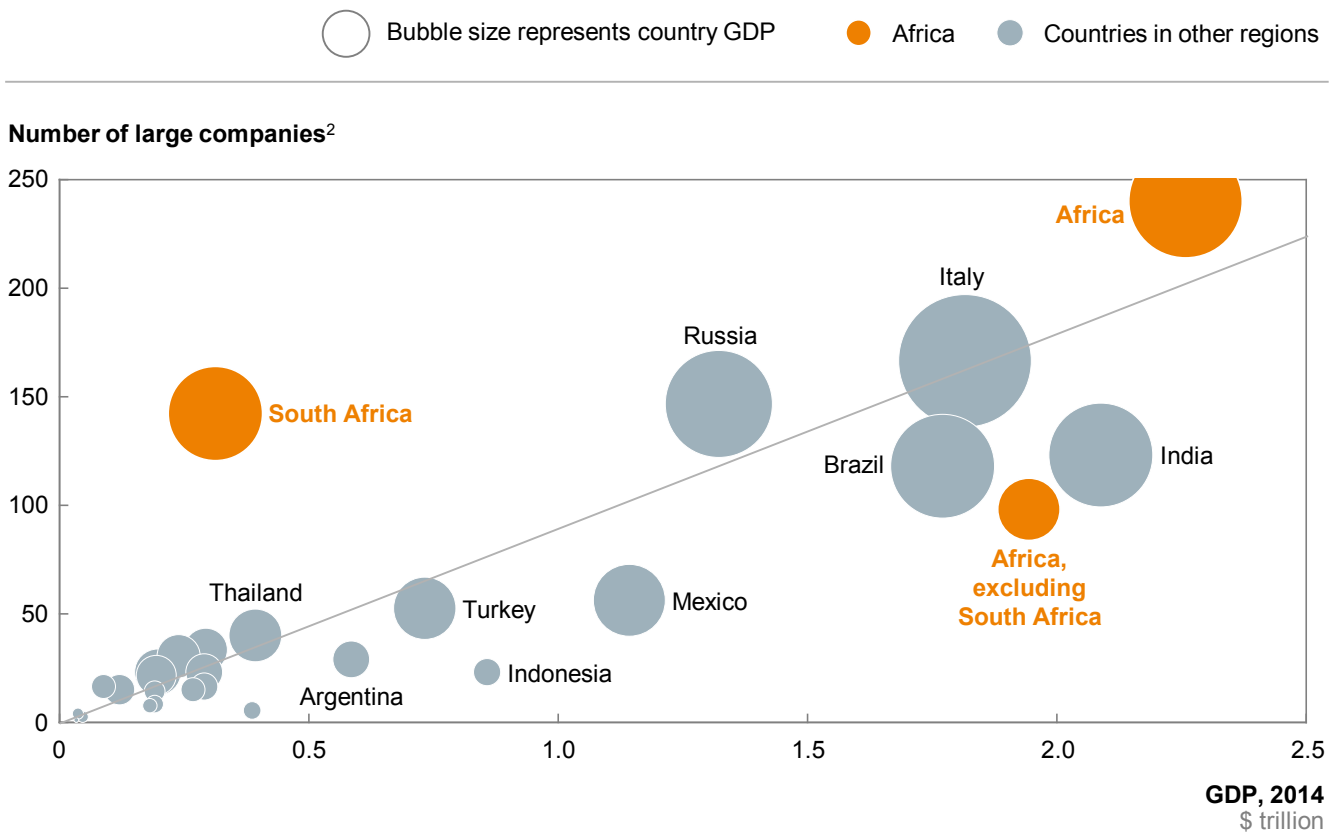
1 Regional definition from the African Development Bank; 2014 or most recent data.
NOTE. Includes multinational corporations with local branches registered in Africa; does not include those based outside of Africa. Numbers may not sum due to rounding.

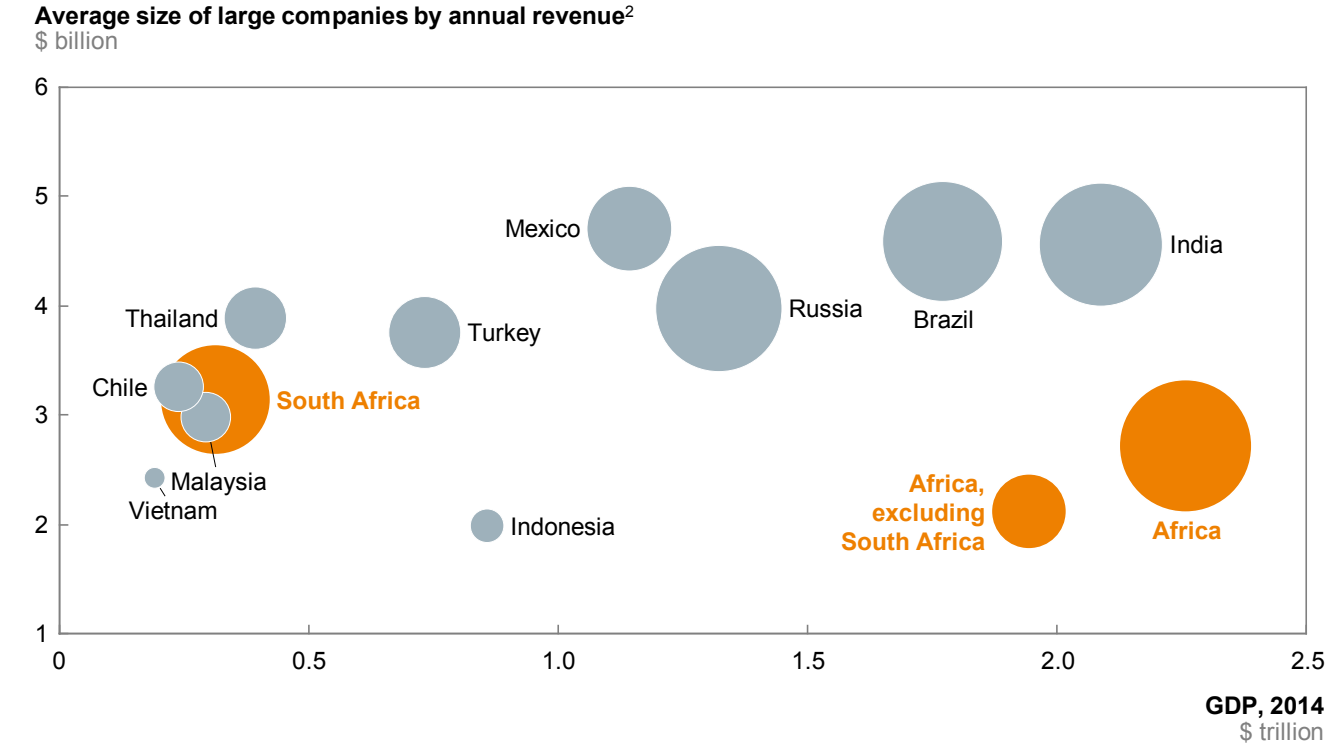
SOURCE: MGI African companies database; McKinsey Global Institute analysis

Moreover, Africa's large companies are smaller, on average, than those in other emerging economies. The average large African corporation has annual revenue of $2.7 billion, compared with around $4 billion to $4.5 billion for large companies in Brazil, India, Malaysia, Mexico, and Russia, for instance. Outside South Africa, Africa's firms earn less than half the revenue of their emerging market peers, at an average of $2.1 billion (Exhibit 46). No African company is featured in the global Fortune 500, which ranks firms by revenue; Brazil and India, whose GDPs are similar to that of Africa, each boast seven companies on that list. China has close to 100.

Exhibit 46

Corporate Africa's revenue pool[1] is a third of what it could be because there are fewer large companies and they are smaller than those in other emerging markets





1 Excluding South Africa.
2 In this analysis, large companies are defined as those with more than $1 billion in revenue per year. These analyses exclude multinational corporations and state-owned enterprises.

SOURCE: McKinsey Companyscope; MGI African companies database; McKinsey Global Institute analysis

Because of these twin issues—too few large firms and too little scale among those that do exist—the total revenue pool of large companies in Africa (excluding South Africa) is about one-third of what it could be.[100]

THE FACTORS BEHIND THE SUCCESS OF AFRICA'S 100 LARGEST COMPANIES PROVIDE LESSONS FOR OTHER BUSINESSES AS WELL AS INVESTORS IN THE REGION

MGI took a close look at the 100 African companies that have outperformed the market in terms of growth and profitability, and we found several key lessons relevant to other businesses and to investors moving into the region. These top 100 firms include African-owned private companies, multinationals, and several state-owned enterprises in a variety of sectors and geographies. Each company was assessed over the course of its entire lifespan (in some cases several decades) to pinpoint which key strategic choices it made that contributed to its growth. The analysis highlights three broad aspects that formed part of the strategy of the large majority of Africa's most successful companies (Exhibit 47).

Nearly half of the 100 major firms have remained focused on their home market even as they have grown in scale, while the rest have steadily expanded into regional or pan-African markets.

14/100
large African companies started with pan-African strategies

Build a strong position in the home market first

The vast majority of Africa's 100 top companies built growth by developing a strong position in their home market first; only 14 started with pan-African strategies. Nearly half of the 100 major firms have remained focused on their home market even as they have grown in scale, while the rest have steadily expanded into regional or pan-African markets. Not surprisingly, almost all the companies that have remained focused on their home market are based in Africa's biggest economies (Box 6, "Learning from the success of large multinationals in Africa," provides an overview of how large foreign firms have built their presence).

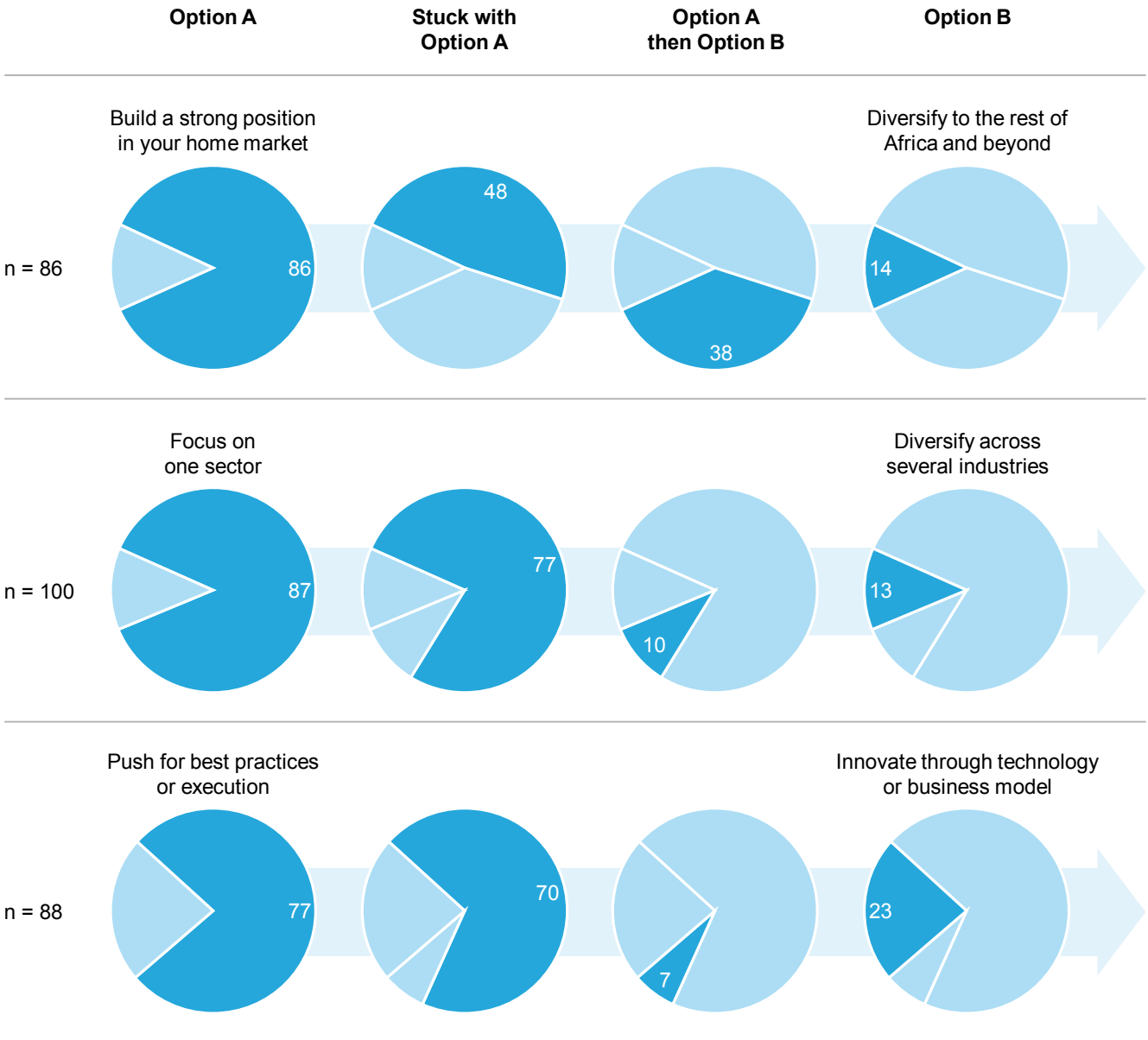
Some companies have relied on organic growth. For example, Kenya-based consumer goods company Bidco Africa has grown its manufacturing business through investments in greenfield manufacturing operations, including palm oil plantations and processing, beverage and bottling production, and animal feed, in Rwanda, Tanzania, and Uganda in addition to Kenya.[101] Others have expanded through mergers and acquisitions. One example is financial services company Attijariwafa bank, which achieved scale in its home market through a merger between two long-established Moroccan banks—Banque Commerciale du Maroc and Wafabank. Today, Attijariwafa bank is Morocco's largest bank, and the sixth largest in Africa by total assets (2013).[102] It used its strong position at home to expand to 12 other countries in Africa, building on its greenfield investments with a series of acquisitions that included Banque du Sud (Tunisia), CBAO (Compagnie Bancaire de l'Afrique Occidentale, Senegal), SIB (Société Ivoirienne de Banque, Côte d'Ivoire), and SCB Cameroun (Société Commerciale de Banque au Cameroun, Cameroon).

[100] The total revenue pool is 90 percent of what it could be when South African companies are included.
[101] Bidco Africa.
[102] Attijariwafa bank; "Top 1000 world banks," *The Banker*, 2014; Dealogic.

Exhibit 47

Most successful African companies have focused on a single sector in their home market, and on best practice, before diversifying and innovating

Strategic choices of 100 successful companies in Africa
% of companies



NOTE: Only companies with relevant growth stories were considered for each dimension.

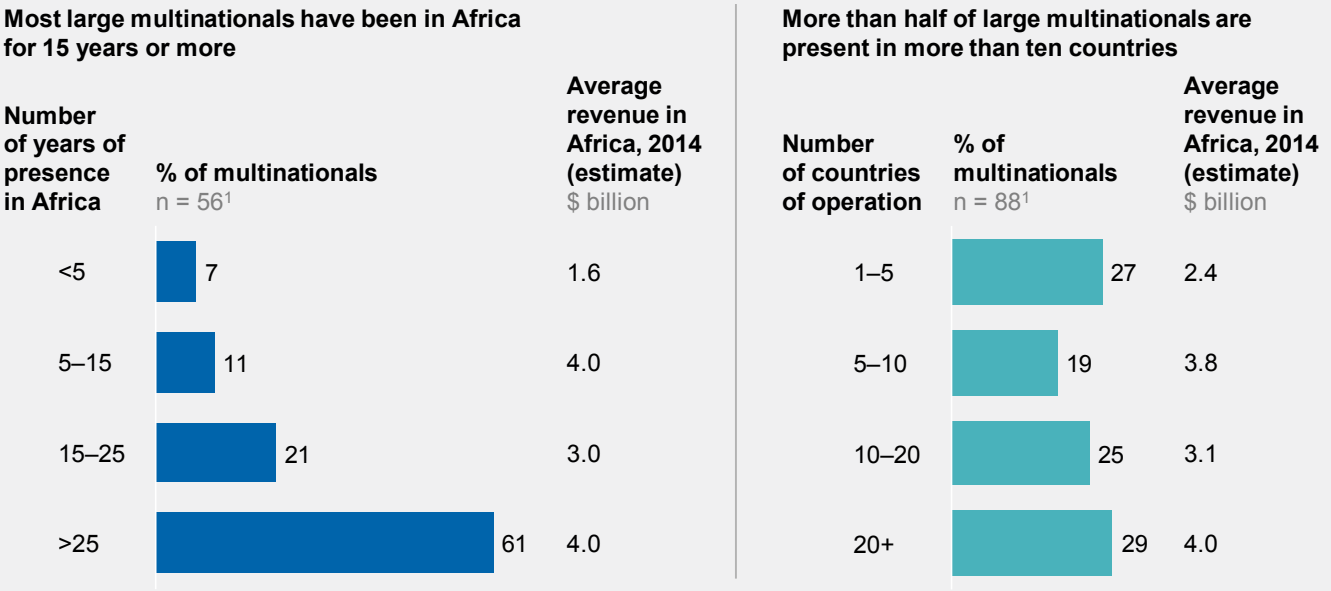
SOURCE: MGI African companies database; McKinsey Global Institute analysis

Box 6. Learning from the success of large multinationals in Africa

The experience of large foreign-based multinationals may provide useful lessons for African companies seeking to build regional scale. Multinationals have played a key role in expanding and deepening the continent's business sector through their investment in the region. MGI has identified about 5,000 individual FDI deals in Africa between 2010 and 2015, primarily in manufacturing, resources, and utilities and transportation. The experience of multinationals demonstrates that pan-African presence takes time to develop, requiring a long-term vision and a step-by-step approach. Most of the large multinationals operating in Africa have been on the continent for more than 25 years. Most are present in more than ten countries, and their longevity and geographic footprint are closely correlated to their revenue base (Exhibit 48). Their investment activity tends to focus on greenfield projects that represent 90 percent of FDI.[1] This is evidence that their growth tends to occur through steady organic growth and smaller acquisitions, with an average deal size of $90 million. While large local African companies have typically built up in large home markets before developing a regional presence, multinationals usually build pan-African businesses.

Exhibit 48

Most successful large multinational corporations have been on the continent for over a decade and have a pan-African footprint



1 Sample size determined by data availability; only multinationals with African revenue of $500 million or more were analyzed.

SOURCE: MGI African companies database; McKinsey Global Institute analysis

1 FDI Markets and Dealogic databases.

Companies that have moved from domestic to regional strategies have used their "first mover advantage" to build scale quickly at home and then use that as the basis for moving aggressively into other markets. Firms in mobile telecommunications fit this pattern. For example, South African-owned MTN made bold moves for growth both by acquiring operating licenses across Africa and by making targeted acquisitions. This strategy increased the number of its subscribers tenfold between 2005 and 2015; during this period, 90 percent of the company's subscriber growth came from outside South Africa.[103] In financial services, Nigeria's United Bank for Africa (UBA) achieved scale in its home market through a series of mergers with medium-sized domestic players.[104] By building a strong domestic position, the bank had a platform to expand beyond Nigeria. For instance, it took a 51 percent stake in the largest bank in Burkina Faso as part of a program that launched UBA-branded subsidiaries in 18 African countries. It is now the third-largest bank in Nigeria, with assets of $14 billion and eight million customers.

Finally, a meaningful presence in one or more of Africa's largest markets is an essential part of a successful pan-African growth strategy. One example is Ecobank. The company has built up a pan-African base in 36 countries and made a large acquisition in Nigeria to establish a substantial presence in a major market.[105]

Focus on one sector

Close to **4/5** of Africa's most successful firms have focused on a single sector

Across a wide range of industries, close to four-fifths of Africa's most successful firms have focused on a single sector rather than diversifying.[106] For example, Shoprite Holdings grew from eight supermarkets in South Africa in 1979 to around 2,200 outlets in 15 countries across Africa and the Indian Ocean islands in 2015, through successive waves of organic growth and acquisitions.[107]

In principle, the tendency toward focusing on a single sector should ensure that African companies are efficient and skilled in the sector in which they operate. But in reality many companies have to diversify their day-to-day operations anyway, by performing internally what would normally be outsourced in other regions. For example, companies may have to focus on their own power generation given the poor state of power delivery, or run their own trucking fleets to ensure a reliable supply chain and delivery of their goods to market. Interviews confirm that this hampers specialization and slows growth.

A meaningful presence in one or more of Africa's largest markets is an essential part of a successful pan-African growth strategy.

When large African companies have diversified into other sectors, which has happened in about 10 percent of cases, this has tended to be limited to adjacent industries—for instance, from resources to resources processing, from agri-processing to retail, or from light manufacturing to technology-intensive manufacturing. One example is Bidvest, a diversified South African corporation that started by providing catering supplies and later moved into hygiene and cleaning services, car dealerships, and freight and logistics

[103] See MTN Group annual reports for 2006, 2010, and 2015.

[104] In 2005, when UBA was Nigeria's third-largest bank, the bank merged with Standard Trust Bank, the country's fifth-largest bank, and then went on to acquire Continental Trust Bank, Trade Bank, Gulf Bank, and Liberty Bank within the following two years. "UBA at a glance," UBA, March 2016.

[105] Ecobank.

[106] In most sectors, at least three-quarters of companies focus on only that sector. The exceptions are services, resources, resources processing, and light manufacturing.

[107] Shoprite Holdings.

services, among other businesses.[108] Another example is the Dangote Group. Known today for its cement business, the company has successfully diversified its interests to fuel growth. Started in 1981 as a trading business, the group diversified by founding Dangote Flour Mills in 1999, followed by Dangote Sugar in 2000. The company then moved into cement production. The group now owns 18 subsidiary companies and operates in six African countries. Its 2.9 trillion naira market capitalization in the first quarter of 2016 accounted for almost 20 percent of the Nigerian Stock Market's total capitalization. Dangote now says that it intends to diversify further, building a 650,000 barrel-a-day petroleum refinery and moving into fertilizer production.[109]

Push for best practices in execution—and strengthen innovation

The large majority of Africa's top 100 companies have driven growth through best-in-class execution and operations, including the development of management and frontline skills. An example is Renault's creation of an institute in Morocco focused on vocational training in the automotive industry.[110] The focus on excellence extends to production systems and distribution networks. In distribution, highly fragmented trade and poor infrastructure, combined with ineffective third-party distributors, pushed Coca-Cola to review its distribution channels. The company set up multiple distribution centers equipped with pushcarts to enable the delivery of much smaller quantities of product to outlets.[111]

The large majority of Africa's top 100 companies have driven growth through best-in-class execution and operations, including the development of management and frontline skills.

23/100
African companies have expanded through innovation

Only 23 of the top 100 have expanded through technological or business model innovation, and only 7 percent of companies that focused on excellent execution have moved into innovation-driven strategies at a later stage. The prevalence of innovation-led growth is much lower among Africa's largest companies than it is among their peers in other emerging regions—particularly Asia, where half of all companies at some point prioritize technological innovation, innovative business models, or product excellence. This is a missed opportunity; to take full advantage of Africa's potential, large firms will need to innovate more.

Those companies that do pursue innovation-based strategies mainly do so through new product and business model offerings. For example, Equity Bank in Kenya targets financially excluded segments through agency banking and zero-opening-balance accounts; it has been so successful that by 2014 it held 57 percent of all bank accounts in Kenya.[112] An example of a successful company that built a new business model using the adoption of new technology is mobile telecommunications operator Safaricom, also in Kenya. The company launched the mobile payment initiative M-Pesa in 2007; today it provides cellphone-based banking services to tens of millions of people in East Africa and beyond.[113] Naspers, a South African-owned media group, transitioned from a printer and publisher into an international company with annual revenue of around $6 billion, by embracing digital

[108] Bidvest.
[109] Dangote Group; Nigerian Stock Exchange fact sheet.
[110] Renault.
[111] Jane Nelson, Eriko Ishikawa, and Alexis Geaneotes, *Developing inclusive business models: A review of Coca-Cola's manual distribution centers in Ethiopia and Tanzania*, Harvard Kennedy School and the International Finance Corporation, May 2009.
[112] *Increasing financial inclusion in East Africa: Equity Bank's agent-driven model*, UNCDF, May 2015.
[113] Safaricom. Also see *M-money channel distribution case—Kenya: Safaricom M-Pesa*, International Finance Corporation case study, June 2010.

media technology, including pay television, e-commerce, and mobile apps.[114] There is room for many more such innovation-focused African companies.

Drawing on the lessons learned from successful companies in Africa and beyond, MGI has distilled five recommendations for companies looking to grow across the continent. First, build a strong position in your home market and use that as a base for expanding into new markets—well beyond your immediate region. Second, adopt a long-term perspective and build the insights and partnerships needed to sustain success over decades. Third, be ready to integrate what would usually be outsourced; otherwise, insufficiently developed supply chains or incomplete distribution networks could hamper your growth. Fourth, look for opportunities in "white spaces" characterized by high growth, high profitability, and low consolidation. Last, invest in building and retaining talent: develop your management team through localization, training, and integration, and shape vocational training programs to create a frontline skills base at scale.

•••

If the continent's business community is to take full advantage of the potential that we see in Africa's economies, from soaring consumer and B2B demand to enormous scope to develop manufacturing, the region needs more companies that develop true scale. The fate of corporate Africa to a great extent lies in its own hands, but governments can strengthen dialogue with organized business, remove barriers, and enable large firms to grow and prosper. In the final chapter of this report, we turn to a discussion of the role governments can play in promoting business dynamism and robust economic growth.

[114] Naspers.

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5. SUSTAINING MOMENTUM—IMPERATIVES FOR GOVERNMENT

6
priorities for African governments, and
1
overarching imperative to improve public-sector leadership and governance

African governments face many challenges, including pressure on public finances, a slowdown in foreign investment, and the need to provide housing, infrastructure, and services in fast-growing cities. At the same time, the global economic slowdown, notably in China, and the related decline in key commodity prices, are making life more difficult for African companies and reinforcing the imperative to develop an environment that enables the dynamism of the private sector.

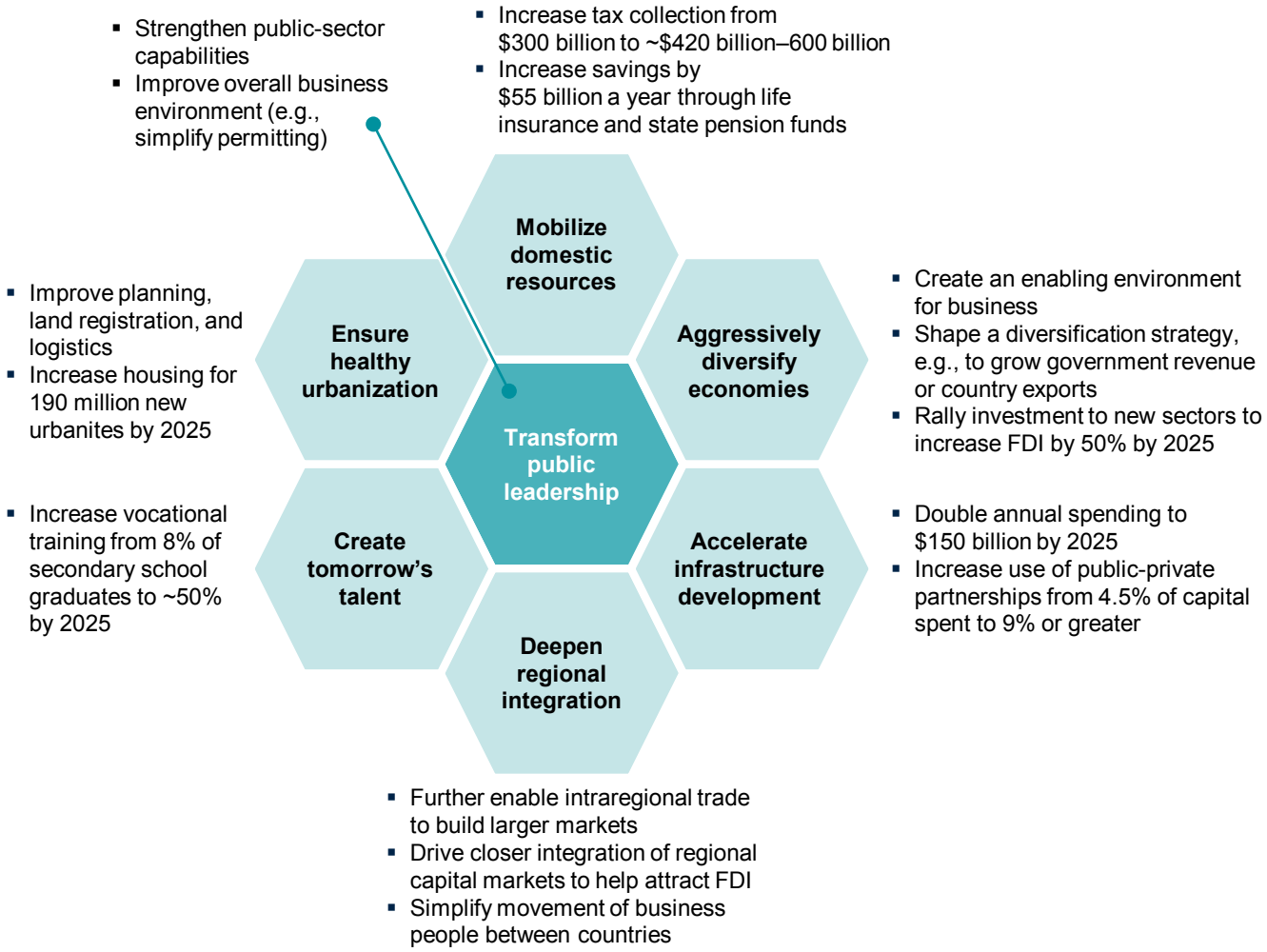
The continent's growing population offers a potential demographic growth dividend, precious in a broadly aging world, but African economies need to be able to create opportunities for an expanding workforce and ensure that their energy is mobilized to fuel economic activity. To enable African economies to meet short-term challenges and make the most of strong long-term fundamentals, governments can prioritize action in six areas and address one overarching imperative—to improve the effectiveness of public-sector leadership and institutions.

There are already promising examples of governments taking action in these six areas, but further effort will be required to have a positive impact on growth as well as on macroeconomic, social, and political stability.

These imperatives relate to mobilizing domestic resources to fund development and business growth, helping to accelerate economic diversification, continuing to ramp up infrastructure investment, deepening regional integration, radically scaling up the development of skills both in the education and vocational training systems, and supporting healthy urbanization (Exhibit 49). There are already promising examples of governments taking action in these six areas, but further effort will be required to have a positive impact on growth as well as on macroeconomic, social, and political stability. It will also help shift resource-dependent economies onto broader growth paths. The six imperatives are relevant to all African countries to greater or lesser extents, and each country's mix of priorities will be influenced by where it stands on the African Stability Index described in Chapter 1. We now examine each of the six priority areas in turn.

Exhibit 49

Governments need to focus on six imperatives and transform their own leadership capabilities and governance


Strengthen public-sector capabilities
Improve overall business environment (e.g., simplify permitting)
Increase tax collection from $300 billion to ~$420 billion–600 billion
Increase savings by $55 billion a year through life insurance and state pension funds
Mobilize domestic resources
Improve planning, land registration, and logistics
Increase housing for 190 million new urbanites by 2025
Ensure healthy urbanization
Aggressively diversify economies
Create an enabling environment for business
Shape a diversification strategy, e.g., to grow government revenue or country exports
Rally investment to new sectors to increase FDI by 50% by 2025
Transform public leadership
Increase vocational training from 8% of secondary school graduates to ~50% by 2025
Create tomorrow's talent
Accelerate infrastructure development
Double annual spending to $150 billion by 2025
Increase use of public-private partnerships from 4.5% of capital spent to 9% or greater
Deepen regional integration
Further enable intraregional trade to build larger markets
Drive closer integration of regional capital markets to help attract FDI
Simplify movement of business people between countries

SOURCE: McKinsey Global Institute analysis

IMPERATIVE 1: MOBILIZE DOMESTIC RESOURCES

Africa needs to take bold steps to mobilize more of its own funding to finance its development—an urgent imperative given weakening currencies, rising interest rate spreads on sovereign debt, and higher volatility in capital inflows to emerging markets. Recent trends have been disappointing. Africa's financial depth—its total financial assets as a percentage of GDP—declined from 108 percent in 2009 to 97 percent in 2015.[115] During the same period, Latin America's financial depth increased from 138 percent to 157 percent, and that of emerging Asia from 257 percent to 286 percent. Africa's savings rate, as we have noted, dropped from 27 percent of GDP in 2005 to 16 percent in 2015.[116] At the same time, lower commodity prices have put the government revenue of resource exporters under pressure. For example, Nigeria's oil revenue declined by an estimated 60 percent between 2011 and 2015.

[115] Estimated for all African countries except Seychelles and Somalia, according to data from the MGI Financial Assets database.

[116] Estimated for 38 African countries representing 86 percent of GDP, according to data from the IMF, *World economic outlook*, April 2016.

African governments have more leeway to generate domestic resources than is often assumed. Our analysis suggests that they have a $355 billion a year opportunity from two levers: improving tax collection to boost government revenue, and increasing domestic investment by expanding the use of pension funds and life insurance. Some countries have already achieved significant progress on both of these (see Box 7, "Nigeria's path to strengthening tax collection and pension funds").

More efficient and fairer tax collection will unlock funding to support key imperatives

Modernizing national tax systems could double Africa's tax revenue, our analysis finds. Tax revenue in Africa today (excluding resource rents) totals between $295 billion and $320 billion, and has grown at an annual rate of 10.5 percent over the past decade. However, tax collection levels are highly uneven. For instance, South Africa's tax-to-GDP ratio stood at 24 percent in 2013, and Kenya's at 19 percent—but countries such as Ethiopia and Tanzania gathered only 12 percent of GDP in taxes, below the average of about 15 percent for the 30 countries we analyzed. In oil-exporting nations such as Angola and Nigeria, tax collection excluding resource rents still makes up less than 10 percent of GDP, despite efforts to improve tax administration in recent years. The result is that just ten countries account for around 80 percent of Africa's total tax revenue; South Africa alone accounts for nearly 30 percent of the total (Exhibit 52).

Africa's generally low tax collection is a result of a number of factors. Government revenue authorities typically have limited data on the number of potential taxpayers, lack effective tracking tools, and have gaps in capabilities and resources. In addition, tax collection processes are often complex and burdensome. The time required by firms to pay their tax is generally longer in Africa than in regions such as East Asia and OECD countries, although there are exceptions, including Kenya, Morocco, and South Africa.

MGI estimates that African governments could increase tax revenue by $120 billion to $300 billion if they were to eliminate non-compliance including fraud, neglect, error, and non-payment.[117] However, they need to overcome a number of structural challenges to achieve this extra revenue, including high levels of informality in business. We estimate that governments could increase the amount of tax they collect (excluding growth in resource rents) by $50 billion to $100 billion by 2025 simply by taking short-term measures to modernize tax systems.[118]

Africa's generally low tax collection is a result of a number of factors. Government revenue authorities typically have limited data on the number of potential taxpayers, lack effective tracking tools, and have gaps in capabilities and resources.

[117] There are no publicly available official estimates of the tax revenue opportunity in Africa, but we estimate that the total lies between $415 billion and $620 billion. We estimate that 30 to 50 percent of Africa's total tax liability is not collected. This range is estimated using available literature, discussions with tax authorities, and McKinsey's experience.

[118] The $50 billion to $100 billion opportunity is achievable by countries within the next decade, based on experience of countries in addressing the taxation levers outlined here. We estimate that a much greater opportunity, worth up to $300 billion in additional tax revenue per year, would be attainable if African governments were to drive higher formalization in the economy and other long-term structural changes.

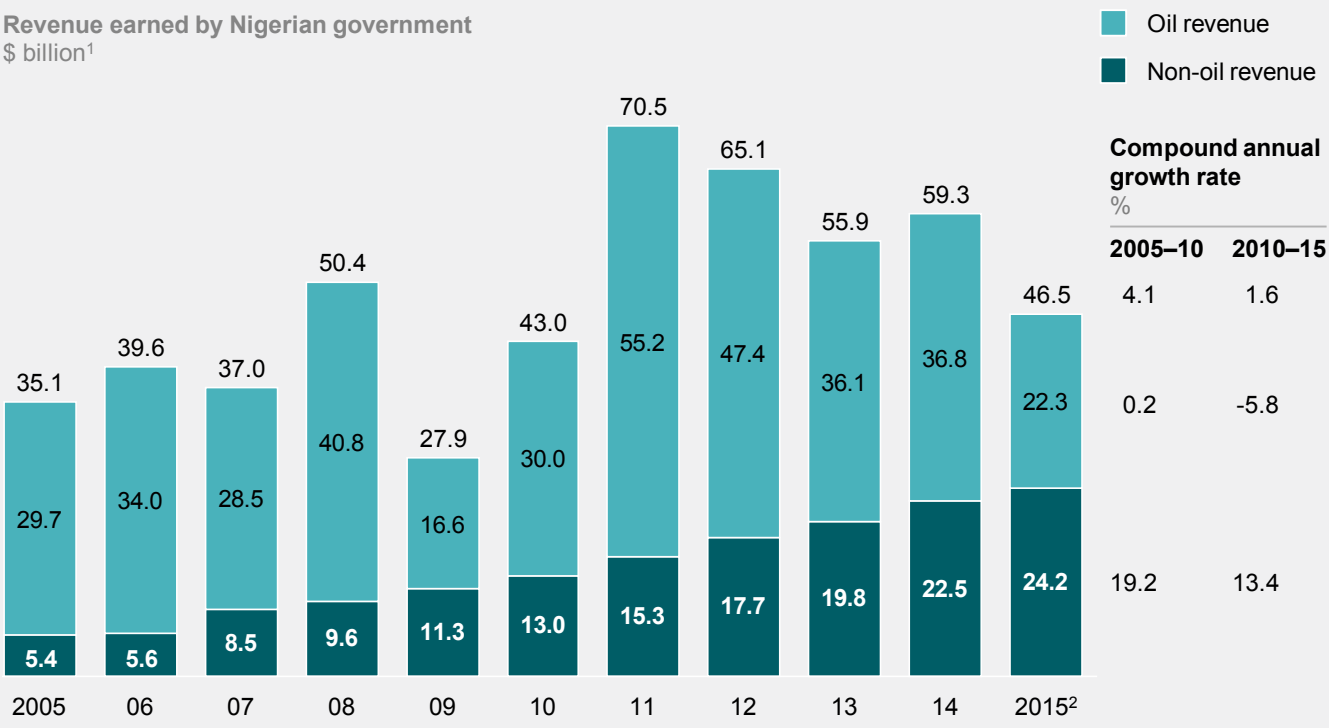
Box 7. Nigeria's path to strengthening tax collection and pension funds

Nigeria has long been dependent on oil revenue to support the bulk of its government spending—but revenue from this source fell by 60 percent between 2011 and 2015 as the price of oil fell sharply and production volumes decreased.[1] The steadily growing challenge to state revenue has lent fresh urgency to the country's efforts to increase non-oil tax collection, including through government measures to improve tax administration. These have included raising compliance by boosting taxpayer registration and strengthening audits, building capacity in revenue collection at the federal and state levels, and modernizing the tax system through increased automation and improved responsiveness to taxpayers.

The impact has been substantial. Non-oil revenue (including tax and customs) has grown by 16 percent a year over the past decade from 0.9 trillion naira ($5 billion) in 2005 to 3.9 trillion naira ($24 billion) in 2015 (Exhibit 50).[2] In 2015, Nigeria's non-oil tax revenue is estimated to have exceeded its oil revenue for the first time. Nigeria still has the potential to raise an additional 9 trillion naira ($56 billion) a year if it can increase its tax collection rate to 14 percent of GDP, the average of its peers.

Exhibit 50

Nigeria has increased non-oil revenue by 4.5 times since 2005



1 Converted using an exchange rate of 160 naira to $1.
2 Preliminary figures.
NOTE: Numbers may not sum due to rounding.

SOURCE: Nigeria Article IV consultation staff reports, 2008 to 2016, IMF; McKinsey Global Institute analysis

1 Nigeria's oil revenue peaked at 8.8 trillion naira ($55 billion) in 2011 and then declined to 3.6 trillion naira in 2015 ($23 billion). These calculations use an exchange rate of 160 naira to $1, typical of that period.

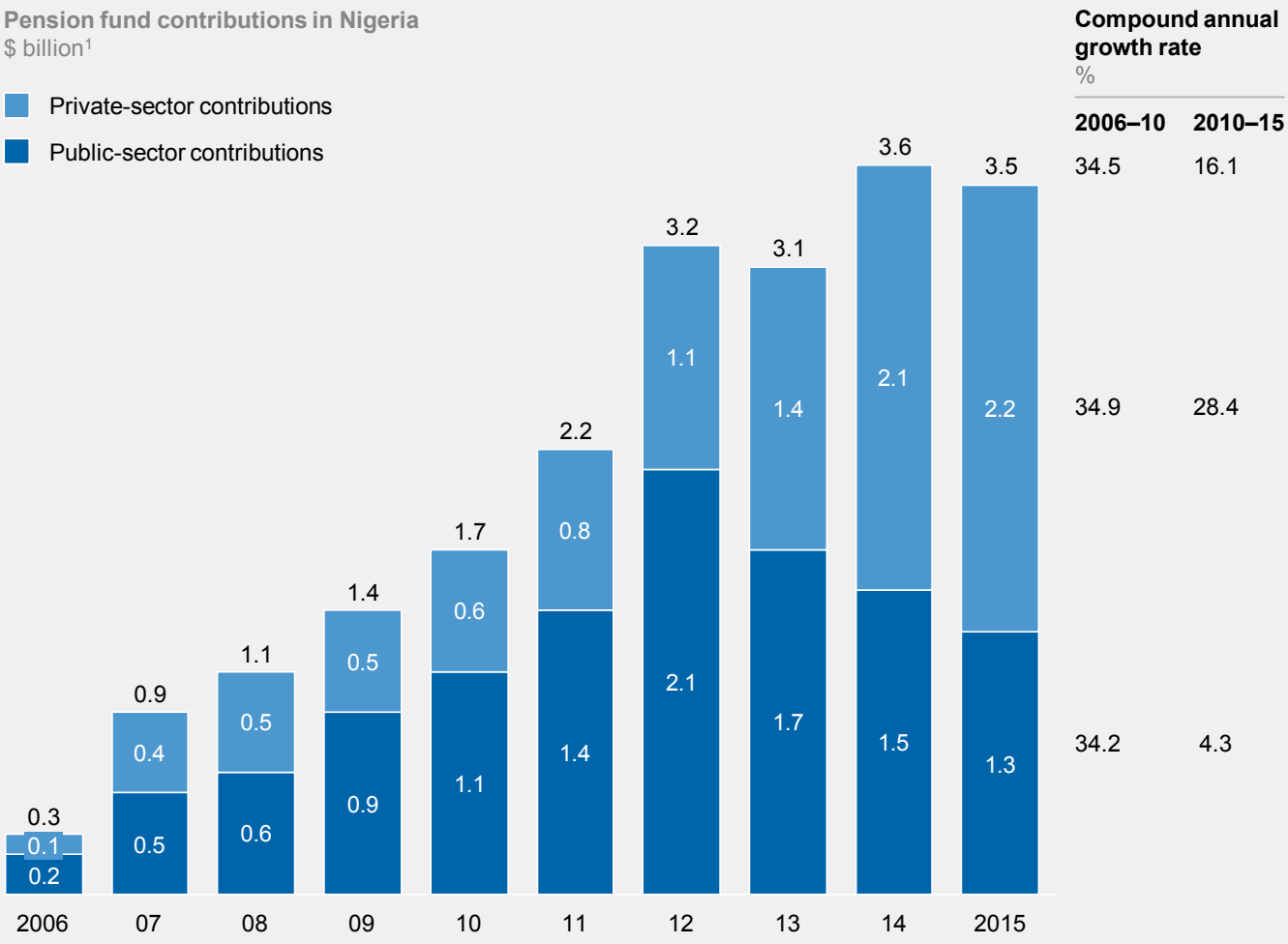
2 Data come from Nigeria Article IV consultation staff reports 2008 to 2016, IMF. Also see Ifueko Omoigui Okauru, ed., *Federal Inland Revenue Service and taxation reforms in Democratic Nigeria*, Safari Books, 2012.

Box 7. Nigeria's path to strengthening tax collection and pension funds (continued)

Nigeria has also instituted far-reaching reform of its pension system over the past decade. Measures have included establishing the National Pension Commission to regulate private and public pensions, and mandating minimum contributions.[3] In 2004, the commission inherited a public-sector pension deficit of 2.3 trillion naira ($14 billion); by 2013, that deficit had turned into a surplus with 3.8 trillion naira ($24 billion) of assets under management.[4] Total pension fund contributions in Nigeria increased at an annual rate of 34 percent between 2006 and 2010, driven by the public sector. From 2010 to 2015, they grew at 16 percent per year, but this time driven primarily by private-sector contributions.[5] The overall effect has been a tenfold increase in annual contributions from 2006 to 2015 (Exhibit 51).

Exhibit 51

Nigerian pension fund contributions have increased by a factor of ten over the last decade



1 Converted using an exchange rate of 160 naira to $1.
NOTE: Numbers may not sum due to rounding.

SOURCE: National Pension Commission, First Quarter Report 2016; McKinsey Global Institute analysis

[3] The Pension Reform Act, Nigeria, was enacted on June 25, 2004. See David Ashiagbor et al., *Pension funds and private equity: Unlocking Africa's potential*, Commonwealth Secretariat, 2014; and *Pension markets in focus, 2015 edition*, OECD. 2015.

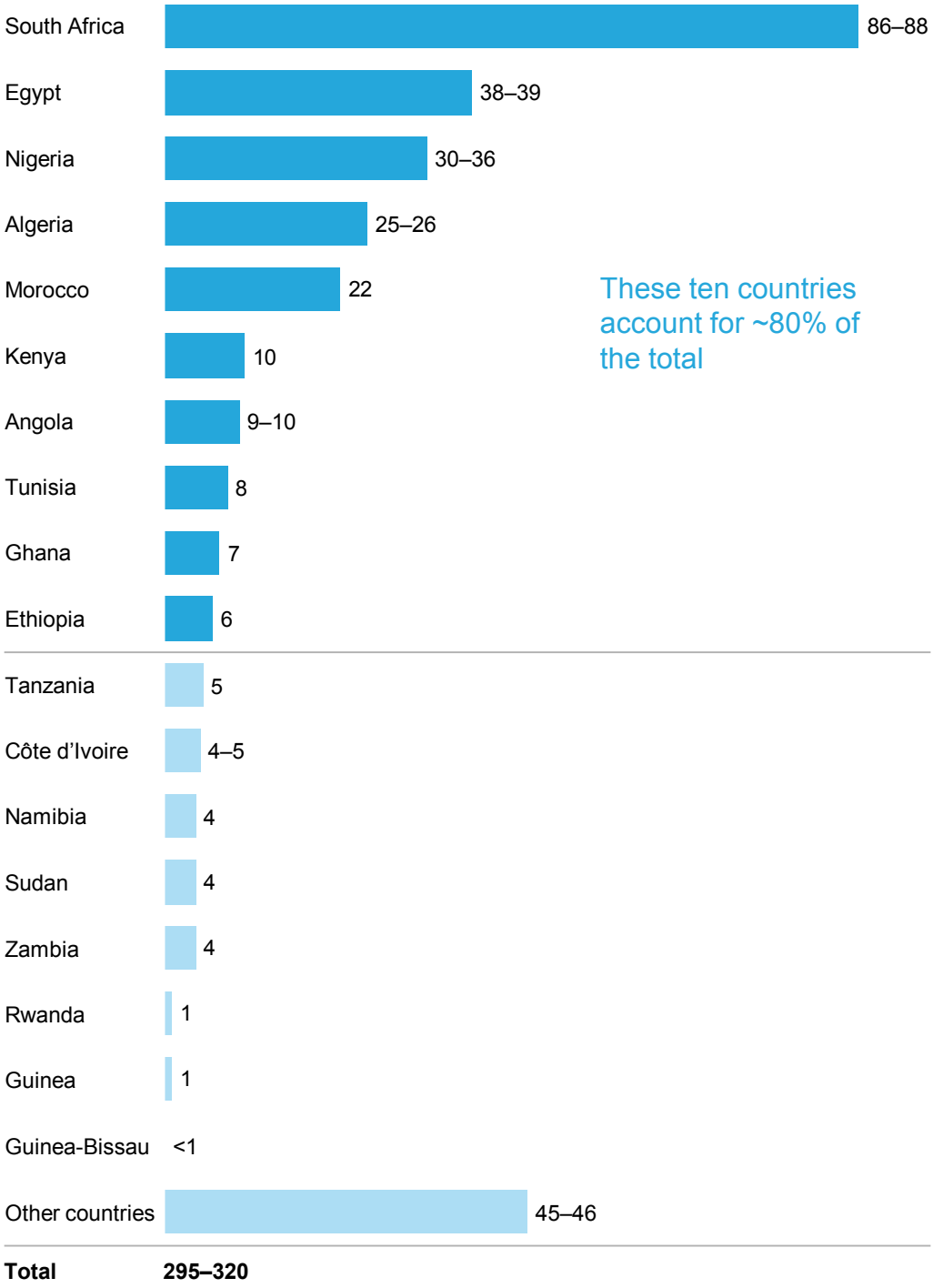
[4] The deficit meant that the current value of liabilities was greater than the value of the assets in the fund at that time. The surplus is the assets in the fund that are left after its liabilities (member entitlements) and reserves (protection against unforeseen circumstances) have been taken into account.

[5] The slowdown in public-sector contributions appears linked to slow adoption of Nigeria's 2014 Pension Reform Act by state and local governments. See Ann Uzoamaka Eche, *Performance of public sector contributions on the growth of the contributory pension scheme in Nigeria*, proceedings of Global Business and Finance Research Conference, Melbourne, Australia, May 2014.

Exhibit 52

Tax revenue in Africa today amounts to approximately $300 billion—and about 80 percent comes from just ten countries

Estimated tax revenue for 51 African countries, 2013[1]
Direct taxes, indirect taxes, trade taxes, stamp duties, corporate tax on oil profits, central and local taxes; does not include resource rents[2]
$ billion



Total	**295–320**

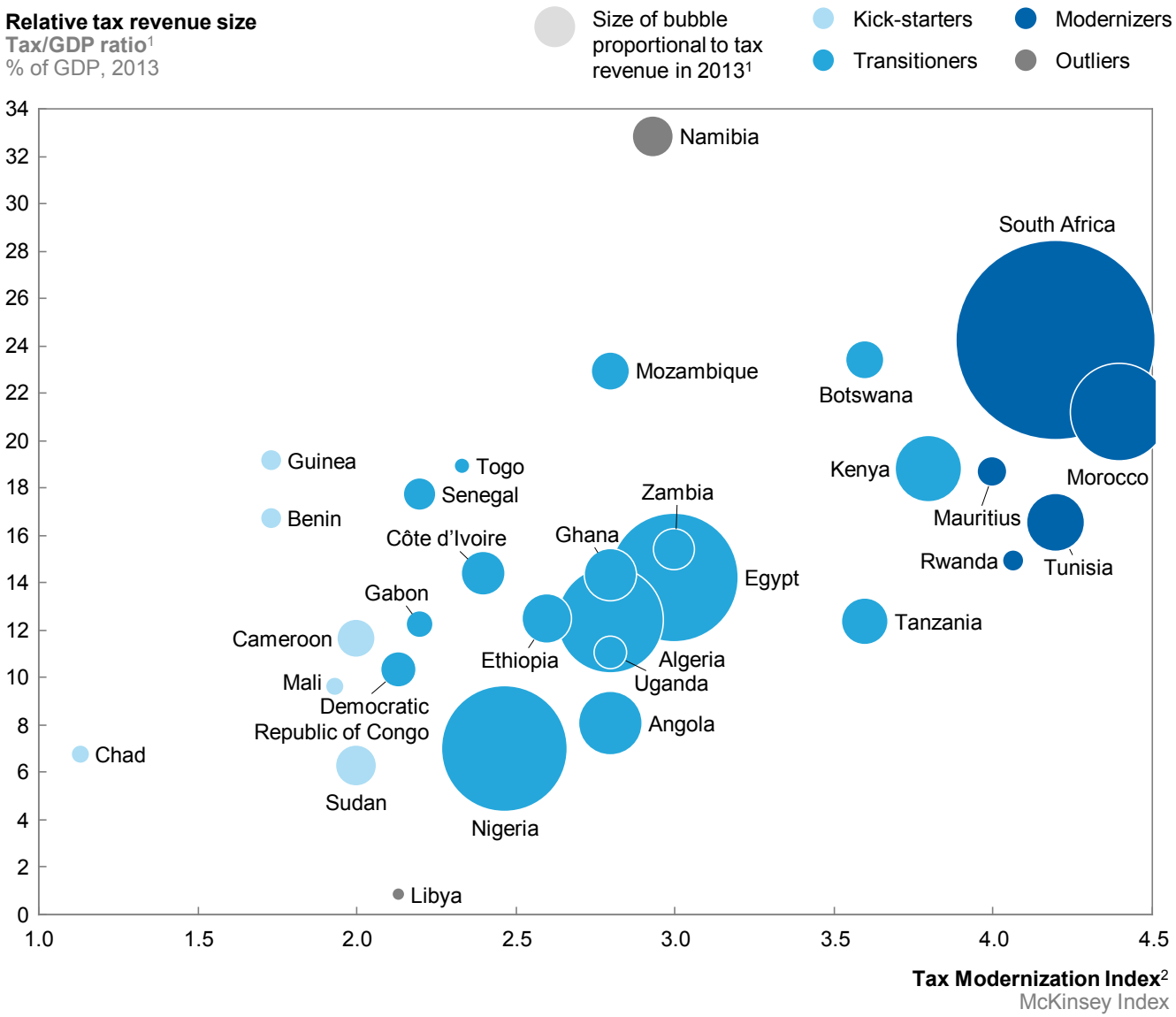
1 Tax revenue range due to exchange-rate variations, various estimates including proxies related to local taxes and corporate tax on oil sector.
2 Direct taxes include taxes on income, profits and capital gains, payroll, workforce, and property. Indirect taxes include taxes on goods and services, value-added taxes, sales taxes, and excise duty. Trade taxes include taxes on international trade and transactions. Resource rents include signature bonuses, licenses, and extraction royalties.
NOTE: Numbers may not sum due to rounding.

SOURCE: African Economic Outlook, African Development Bank; OECD Development Centre; UNDP; national finance ministries; McKinsey Public Sector Practice; McKinsey Global Institute analysis

McKinsey has developed a Tax Modernization Index that identifies three archetypes of countries—we call them "kick-starters," "transitioners," and "modernizers"—each of which requires different measures to strengthen tax administration, build capabilities, and boost revenue (Exhibit 53).[119]

Exhibit 53

Three country archetypes each require their own modernization initiatives



1 Higher range of tax revenue from McKinsey estimates (direct taxes, indirect taxes, trade taxes, stamp duty, corporate tax on oil profits, and central and local taxes). Does not include resource rents, e.g., signature bonuses, licences, and extraction royalties.
2 Three types of metrics were used to calculate the Tax Modernization Index: informality (level of informal small and medium-sized enterprises, level of financial inclusion); tax system (time taken to prepare and pay taxes, number of tax payments); and tax administration (level of e-filing for corporations, qualitative assessment of tax administration modernization).

SOURCE: *African Economic Outlook*, African Development Bank, OECD Development Centre, UNDP; McKinsey Public Sector Practice; McKinsey Global Institute analysis

[119] Three types of metrics were used to calculate the Tax Modernization Index: informality (level of informal small and medium-sized enterprises, level of financial inclusion); tax system (time taken to prepare and pay taxes; number of tax payments); and tax administration (level of e-filing for corporations, qualitative assessment of tax administration modernization).

- **Kick-starters.** This archetype includes several of Africa's smaller countries, typically with legacy tax systems, that collect a relatively small proportion of GDP in tax revenue. They could implement several initiatives in the short term, including standardizing and simplifying internal processes, closing major tax loopholes, and improving collection procedures.

- **Transitioners.** This group includes countries such as Angola, Ghana, Nigeria, and Kenya that typically have more established tax systems and have begun the journey toward modernization. These countries can advance to even higher-quality systems through broad-ranging tax reform that would include, for example, further diversifying the tax system, upgrading IT infrastructure, increasing the use of pre-filing and e-filing, and introducing more sophisticated compliance programs.

- **Modernizers.** This archetype includes countries such as Morocco and South Africa that already raise a significant proportion of GDP as tax revenue and have well-functioning tax systems. They have an opportunity to build state-of-the-art tax administrations, rolling out targeted modernization initiatives to improve customer experience, for instance, and using advanced risk analytical engines to improve compliance.

Across all three sets of countries, there are several shared opportunities, including reducing informality to expand the tax base, balancing tax incentives and exemptions to attract FDI without overly eroding tax revenue, and strengthening the administration of tax systems by improving data collection, using data to drive risk-based compliance, and better enforcement. A successful modernization program requires a well-designed road map for the next decade that details the specific transformations needed, with clear short- and long-term objectives, and a strong team to deliver it.

Expanding life insurance and pension funds can stimulate savings and domestic investment by $55 billion a year

Life insurance and pension funds—two of the most significant drivers of investment in other regions—remain underutilized in Africa. Raising their use could increase domestic investment by approximately $55 billion a year by 2025, a 65 percent increase on 2014 levels (Exhibit 54). To put these numbers in perspective, FDI inflows into Africa between 2010 and 2014 averaged $48 billion per year. Unlocking additional domestic resources could provide substantial economic stimulus.[120]

Life insurance and pension funds—two of the most significant drivers of investment in other regions—remain underutilized in Africa.

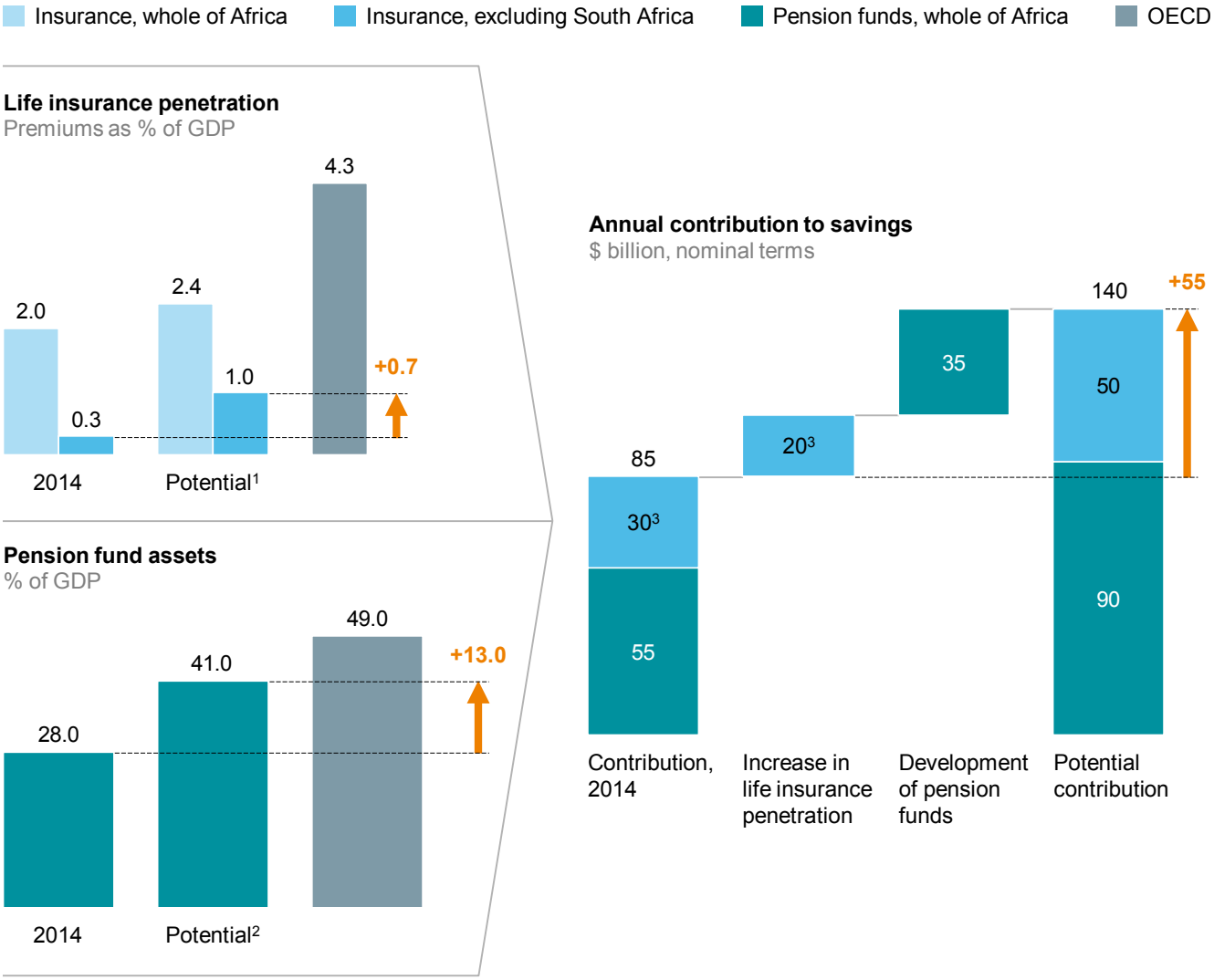
In most of Africa, life insurance as an industry is nascent. Across the continent, life insurance premiums amounted to 2 percent of GDP in 2013, compared with an average of 4.3 percent in OECD countries. Outside South Africa, which accounts for nearly 90 percent of the continent's life insurance business by volume, premiums fall to just 0.3 percent of GDP. In these other markets, life products are primarily still focused on protection, such as compulsory death insurance, which offers limited long-term investment potential. The industry in these countries will need to transition to offer more investment-oriented products. If governments and business fostered increased insurance penetration, the industry could

[120] For example, South African pension funds must invest at least 85 percent of their portfolio domestically—a threshold set by the regulator—and split it among equity, bonds, property, and cash. Equity investment can include infrastructure investment.

grow very quickly. MGI's estimate of the potential evolution of demand in each country shows that penetration could triple from 0.3 percent to 1 percent of GDP (outside South Africa), increasing the continent's premiums by two-thirds to $50 billion within ten years.[121]

Exhibit 54

Increasing the penetration of pension funds and life insurance products would stimulate increased domestic investment of $55 billion



1 Based on estimates of life insurance growth by country for 44 countries in Africa in 2014 and in 2025
2 Based on increasing every countries pension fund assets to a minimum of 28% of GDP, which was the average of 12 countries in Africa in 2014
3 Excludes the contribution of group life premiums, estimated at 40% of total life insurance premiums based on South African data. These are excluded because of their short-term nature, which does not dispose them towards long-term investment.

SOURCE: Swiss Re Sigma; Africa Re; World Development Indicators 2016, World Bank; OECD; McKinsey Global Insurance Pools; McKinsey Global Institute analysis

To achieve this step change, governments need to modernize insurance legislation, ensure greater transparency on the products offered, and strengthen financial inclusion. Legislation could facilitate credit life coverage (for retail credit or loans) and group life coverage for the workforces of large private and public employers.[122] Countries can

[121] The continent's total premiums were an estimated $50 billion in 2014. Based on data from South Africa, we estimate that $30 billion of premiums are on products suitable for long-term investment. In our estimate, we remove about 40 percent of total premiums on short-term products such as group life coverage.

[122] These are year-to-year premiums. They will not drive higher investment but will encourage familiarity with, and acceptance of, insurance products. The ideal products to drive increased investment are endowment policies, retirement annuities, or life insurance policies.

also require the localization of reinsurance—accounting for up to 20 percent of total life insurance premiums—as Namibia has done.[123] To move toward greater financial inclusion, governments and public agencies can promote consumer education about the benefits of insurance. Companies in the sector also need to develop low-cost service offerings, in a similar manner to innovations in retail banking that make use of digital or mobile phone banking services. Finally, countries need to promote healthy, liquid capital markets to ensure that insurance companies can invest in instruments that match the duration of their liabilities.

Pension funds are another powerful savings and investment-building tool. Across Africa, pension fund assets stood at 28 percent of GDP in 2014, but the figure varies significantly among countries. Pension fund assets in Morocco, Namibia, and South Africa exceeded 70 percent of GDP in 2014, while in Ghana, Kenya, and Nigeria they were less than 15 percent. We estimate that, across the continent, pension funds could increase to an average of 41 percent of GDP by 2025, close to the OECD average of 49 percent. This would increase funds' total assets under management by nearly 65 percent—and provide a $35 billion boost to private investment in Africa.

Pension fund assets were **28%** of Africa's GDP in 2014

To achieve this boost, governments would need to put in place clear regulatory frameworks to incentivize savings in pension funds. One example of an African country taking this approach was Nigeria with its 2004 Pension Reform Act, which made contributions to retirement funds mandatory in both the public and private sectors. Across Africa, the resulting growth in pension funds would be large enough to encourage the industry to develop more broadly. We estimate that state pension funds alone could generate up to $18 billion a year in savings if all state employees across Africa were included. To ensure that funds flourish, however, it is critical to establish mechanisms to guarantee their solidity, transparency, and sound governance and management. Governments would need to set appropriate limits on which assets these funds could invest in; several countries restrict pension fund investments to government bonds, but allowing investments in other long-term asset classes such as infrastructure would also be beneficial.

IMPERATIVE 2: AGGRESSIVELY DIVERSIFY ECONOMIES

There are powerful arguments in favor of diversification.[124] It can improve macroeconomic stability, reduce volatility, ensure a more reliable growth trajectory by unlocking production in new sectors, and help reallocate resources to more productive activities. Around the world, several countries have achieved rapid diversification over short periods. For example, South Korea and Turkey both increased their service and manufacturing shares of GDP by around 20 percentage points from 1965 to 1980.

68% Combined GDP share of services and manufacturing in 2014, from 65% in 1999

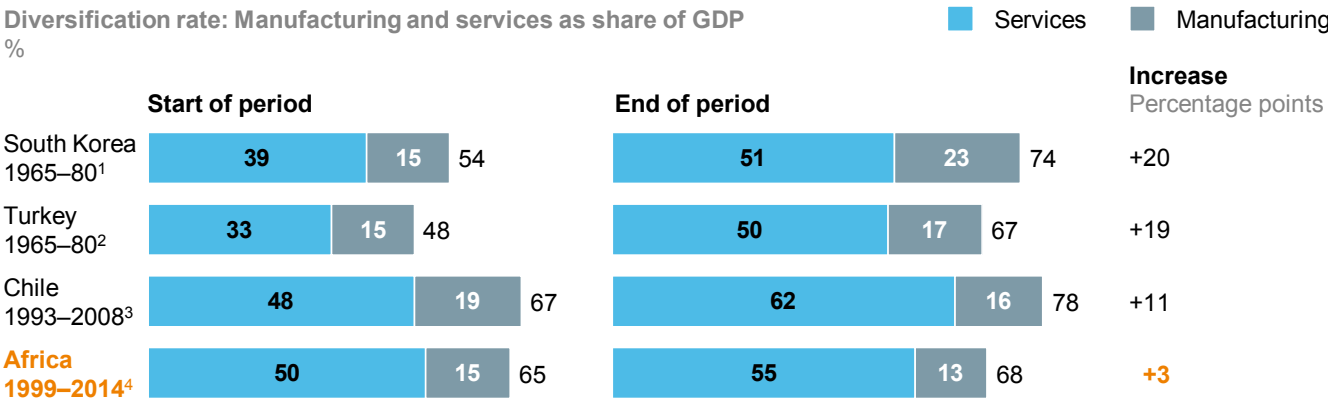
In Africa, several countries are pursuing ambitious diversification strategies. Two examples, as we have discussed, are Morocco's initiatives to accelerate global innovations exports and Ethiopia's industrialization strategy. Across the continent as a whole, however, diversification has been relatively slow. The combined share of services and manufacturing grew from 65 percent of GDP in 1999 to 68 percent in 2014 (Exhibit 55). Resources and agriculture still account for a large proportion of government revenue in many countries. They also make up a major share of goods exported—98 percent in Angola, 92 percent in Nigeria, 80 percent in Zambia, and 45 percent in South Africa, for example—heightening many economies' vulnerability to commodity price volatility (Exhibit 56). There is an urgent need to drive diversification in a larger number of African economies and to accelerate the pace in economies that are already reasonably diversified.

[123] McKinsey Financial Services Practice.

[124] See, for instance, Dani Rodrik, "The return of industrial policy," Project Syndicate, April 2010, and Tim Callen et al., *Economic diversification in the GCC: Past, present, and future*, IMF staff discussion note number 14/12, December 2014. At the same time, there are examples of unsuccessful diversification attempts, leaving many questions about which policies are most likely to be effective. For further discussion, see, for instance, *How to compete and grow: A sector guide to policy*, McKinsey Global Institute, March 2010.

Exhibit 55

African economies have diversified less than other countries' economies over the past 15 years

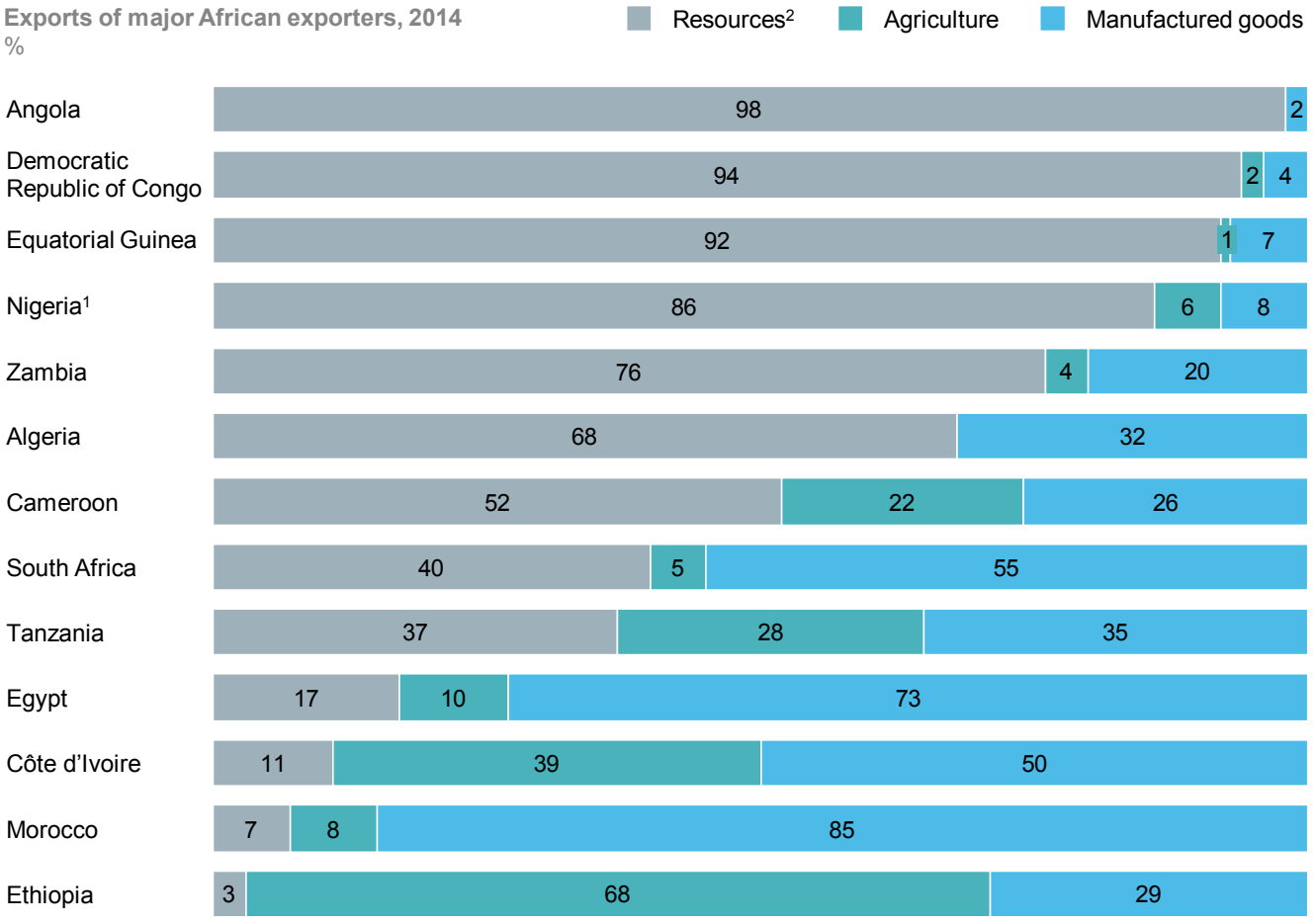


1 South Korea's GDP grew at 10% per year over this period.
2 Turkey's GDP grew at 4.9% per year over this period.
3 Chile's GDP grew at 4.9% per year over this period.
4 Africa's GDP grew at 4.8% per year over this period.
NOTE: Numbers may not sum due to rounding.

SOURCE: World Development Indicators, World Bank; McKinsey Global Institute analysis

Exhibit 56

Many of Africa's largest exporters are dependent on commodities for exports



1 2013 data.
2 Resources includes certain types of intermediate processed resources (e.g., copper plates).
NOTE. Data labels <1 not shown. Numbers may not sum due to rounding.

SOURCE: UN Comtrade; McKinsey Global Institute analysis

Governments should consider strategies to expand high-potential sectors in close cooperation with business, based on a clear understanding of their countries' comparative advantages. To be successful, any diversification strategy needs to be guided by a long-term national vision that sets transparent objectives, sends a clear signal to investors in focus sectors, and guides resource allocation and trade-offs. To support diversification, governments can also take steps to improve the enabling environment for business, including strengthening transportation and electric power infrastructure, increasing openness to foreign investment, and reviewing new-business registration, bankruptcy laws, and other key regulations.

Strengthening the enabling environment for business

As a starting point for accelerating diversification, governments need to take action to put in place a strong enabling environment for business. Africa's business environment has improved over the past 20 years, but the continent is still not as attractive to businesses as in other regions. In the World Bank's 2016 *Doing business* report, 35 of the 50 lowest-ranked nations were in Africa. Only seven African countries—Mauritius, Rwanda, Botswana, South Africa, Tunisia, Morocco, and Seychelles (in order of ranking)—were in the top half of the ranking.

Several factors contribute to the challenging business environment. Policy is one: mining and exploration companies rank Africa's policy environment poorly compared with other regions, and this is a significant brake on investment in the sector. Electric power is another challenge. Nearly half of companies in Nigeria and more than one-third in Angola and Egypt identify access to electricity as a major constraint. Firms in these countries reported that power outages cost them 5 to 10 percent of annual sales.[125] Logistics, despite recent improvement in some countries, remains another constraint. In Nigeria and Angola, costs and lead times for air and sea freight—for both exports and imports—can be double those in Brazil, China, and India.[126] Taken together, such factors impose considerable extra costs on African businesses. One World Bank study found that input costs in light manufacturing sectors such as apparel, agribusiness, leather, and wood and metal products in Ethiopia, Tanzania, and Zambia were at least 25 percent higher than in China.[127] The reasons for this included regulations (including on imports and land access), poor trade logistics, and the high cost of electric power.

5–10%
of annual sales lost from electricity outages in Angola, Egypt, and Nigeria

Another issue that governments can address is the prevalence of informal firms. Of firms surveyed by the World Bank in Africa, almost 40 percent—a higher share than in comparable emerging markets—ranked informal practices as a major constraint, while 65 percent of firms in sub-Saharan Africa stated that they had to compete against unregistered or informal firms.[128] Informal or unregistered businesses typically do not pay tax or comply with labor and other regulations, and that means unfair competition for companies in the formal sector. These informal businesses may also be challenging to secure as customers because they operate outside of formal financial and tax systems.

Attention is needed on several other imperatives highlighted in this chapter, including attracting investment, fostering healthy urbanization, strengthening the skills base, and upgrading power and logistics infrastructure.

[125] World Bank Enterprise surveys on Angola in 2010, Egypt in 2013, and Nigeria in 2014.
[126] *Logistics performance index 2014*, World Bank, March 2014.
[127] *Light manufacturing in Africa: Focused policies to enhance private investment and create millions of productive jobs*, World Bank, 2012.
[128] This was the highest of any region. See *Enterprise surveys*, World Bank, 2016.

Shaping a targeted diversification strategy based on comparative advantages

Building on this foundation, countries need to analyze the drivers of growth and competitiveness in specific sectors, rather than simply a macro-level view of the economy. Previous MGI research suggests that policy must be tailored to distinct sectors, as sectors differ in their competitive dynamics and responsiveness to government intervention.[129] Guided by insights into each country's sectors, governments can choose an economic diversification route aligned with their specific comparative advantages.

For instance, low labor costs present countries with an opportunity to grow in a number of labor-intensive service and manufacturing industries, provided that they can build the necessary skills, productivity, and transportation and communication infrastructure. Geographic proximity to large markets is also an advantage. Based on their understanding of such endowments, governments can set out a clear strategy to grow high-potential sectors in close cooperation with business, as Morocco has done in the cases of manufacturing, agri-processing, and business process outsourcing. Kenya provides another example: its Vision 2030 makes economic diversification the main thrust of the country's development strategy. Successful diversification strategies typically happen over long periods, and must be guided by a long-term national vision that sets transparent objectives, sends a clear signal to investors in focus sectors, and guides resource allocation and trade-offs.

As we discussed in Chapter 3, Africa has the potential to accelerate its manufacturing growth significantly. This is an important route to diversification of an economy and its exports. As governments review their industrial policy to encourage the potential in manufacturing, decisions they make will affect the productivity of local firms and investment decisions by international companies. Making choices that create the right enabling environment will be critical. Countries cannot rely exclusively on low labor costs; rather, they need to take steps to strengthen competitiveness across the board through three main focus areas.

- **Improving productivity.** Beyond governments putting in place basics such as reliable power logistics, and development of industrial land, achieving higher productivity will require aggressive modernization of domestic production and the national skills base.

- **Enabling markets to grow.** Governments can play a role in expanding the markets for African manufacturers through deeper regional integration and by further leveraging trade agreements to access international markets. For instance, they can capitalize to a much greater degree on the preferential access to the US market that AGOA provides, and seek similar deals in other key markets around the world.

- **Integrating local industries into global supply chains.** Countries will need to attract international manufacturing companies and investors to help develop manufacturing clusters with capital and skills that can then be integrated into global supply chains. To achieve this, governments need, for instance, to actively market African capabilities and products, bolster investment-promotion agencies, streamline imports of partially manufactured goods (typically components), and offer special economic zones backed by reliable infrastructure.

[129] *How to compete and grow: A sector guide to policy*, McKinsey Global Institute, March 2010.

x3
capital inflows to Africa, 2005–10

Developing ways to attract investment in sectors that have comparative advantage

A final step is to further increase Africa's attractiveness as a destination for foreign investment. The continent has already achieved significant success in this regard. Total capital inflows tripled between 2005 and 2010, with the FDI component increasing from $29 billion to $41 billion over that period, with a peak of $60 billion in 2008. Yet FDI inflow growth has since flattened, averaging $48 billion between 2010 and 2014. Africa's share of global FDI has ranged between 2 and 3 percent over the past decade, while Latin America increased its share from 3 to 9 percent and emerging Asia from 9 to 21 percent; both these regions have substantially increased their share of global FDI inflows.[130] Africa can aspire to raise its growth in capital inflows so that it at least keeps pace with GDP growth, which the IMF forecasts at just over 4 percent per year until 2020 (in real prices). This would increase Africa's capital inflows by 50 percent by 2025.

A clear FDI strategy, backed and driven by senior political and business leaders, can be linked to African countries' diversification strategies. The FDI strategy would include marketing, investment-promotion agencies, and efforts to ensure that international investors have clarity on policy and regulation. To make a country's opportunities visible to investors, a marketing plan would set out a narrative on the sectors the country is prioritizing (on the basis of comparative advantage) and would signal that it is "open for investment." A dedicated investment agency is a proven vehicle for driving and customizing such an outreach program that targets both entire overseas economies and specific high-potential companies. Large, highly visible flagship investment opportunities that offer attractive conditions to investors and focus on specific steps in relevant value chains could be structured. This support to investors should continue after the investments are made and projects are in progress. The Rwanda Development Board has proved effective at providing ongoing support to investors well after a deal is signed. That support includes facilitating business registrations, resolving bottlenecks and mediating any issues related to land and utilities, and introducing investors to local and international firms.[131]

To implement all these steps, governments need to consider how to strengthen the effectiveness of public-sector delivery. This can be done by setting up dedicated delivery units or task forces and partnering with the private sector.

IMPERATIVE 3: ACCELERATE INFRASTRUCTURE INVESTMENT

Poor infrastructure, including electricity provision, and poor transportation links contribute to the lack of scale among Africa's companies and hinder regional integration. Africa's spending on infrastructure has doubled from an average of $36 billion in 2001–06 to $80 billion in 2015 in nominal terms. As a share of GDP, however, infrastructure investment has remained at around 3.5 percent, less than the 4.5 percent that MGI research has found is necessary each and every year until 2025. In absolute terms, this means doubling annual investment in African infrastructure to $150 billion. Governments need to develop bankable projects, ensure adequate financing, put in place effective public-private partnerships, and optimize spending.

As a result of Africa's progress in increasing infrastructure investment, the share of sub-Saharan African households with access to electricity increased from 26 percent in 2000 to 32 percent in 2013; those with access to running water rose from 55 percent in 2000 to 68 percent in 2015. Over the same period, mobile phone penetration increased from 2 percent of the population to 77 percent.

[130] IMF Balance of Payments database; and World Development Indicators, World Bank.
[131] Rwanda Development Board.

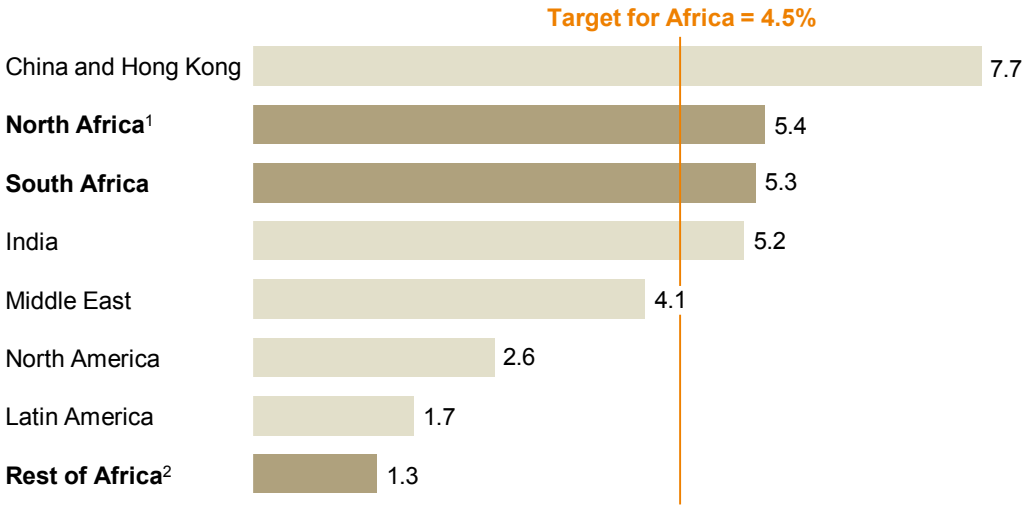
But there are still huge gaps. As we have noted, many companies in Africa's large economies identify access to electricity as a major constraint. If Africa is to achieve its manufacturing potential and meet the needs of growing cities, more investment in power generation and distribution is urgently needed. Boosting production, regional trade, and exports will also require more investment in logistics in addition to existing initiatives in this area.

Spending levels are uneven: North Africa and South Africa spend more than 5 percent of GDP on infrastructure each year (well above the proportion in other emerging regions), but other countries analyzed averaged only 1.3 percent (the lowest of all regions) (Exhibit 57).

Exhibit 57

Outside South Africa and North Africa, the region spends only 1.3 percent of GDP on infrastructure—a significant gap with what is needed

Average infrastructure spending, 2010–15
% of GDP



1 North African average based on Morocco and Tunisia.
2 Rest of Africa average based on Cameroon, Kenya, Nigeria, Senegal, and Zimbabwe.

SOURCE: McKinsey Infrastructure Spend and Stock Database; McKinsey Global Institute analysis

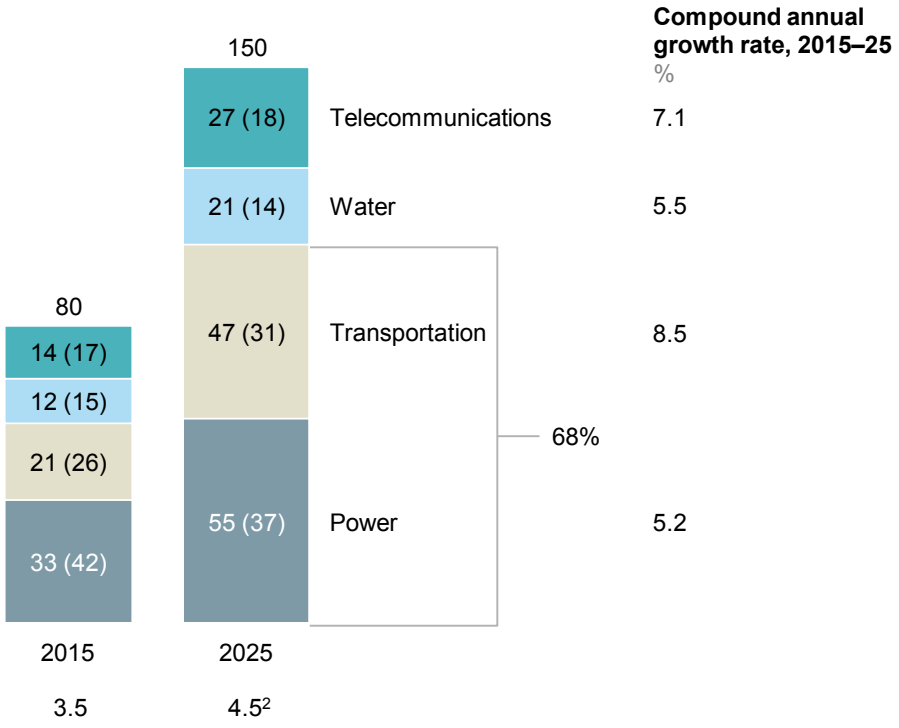
Overall, MGI estimates that Africa needs to spend 4.5 percent of GDP on infrastructure each year to 2025, an increase of one percentage point over 2010–15. This level of spending would enable the continent to build its infrastructure stock to approximately 70 percent of GDP within a decade, a level MGI has identified as typical for economies with good infrastructure. That corresponds to another doubling of spending to around $150 billion in 2025 (Exhibit 58). Based on benchmark levels of spending, Africa's investment in transportation infrastructure will need to increase from $21 billion in 2015 to $47 billion in 2025, and investment in power infrastructure will need to rise from $33 billion to $55 billion.[132]

[132] *Infrastructure productivity: How to save $1 trillion a year*, McKinsey Global Institute, January 2013.

Exhibit 58

Africa's spending on infrastructure needs to double from $80 billion in 2015 to ~$150 billion in 2025, with two-thirds spent on power and transportation

African annual infrastructure investment needed by sector[1]
$ billion (%)



1 Forecast spending need based on international benchmarks of infrastructure stocks and depreciation as a percentage of GDP; does not take into account potential optimization levers.
2 Spending 4.5% of GDP every year will allow Africa to build up its infrastructure stock levels to approximately 70% of GDP within a decade, a level that MGI has identified as typical for economies with good infrastructure levels.

SOURCE: McKinsey Infrastructure Stock and Spend Database; IHS; International Transport Forum; McKinsey Global Institute analysis

The need to boost investment is particularly pressing outside of South Africa and the North African nations, which already spend more than 5 percent of GDP on infrastructure. Cameroon, Kenya, Nigeria, Senegal, and Zimbabwe together spent an average of 1.3 percent of GDP on infrastructure between 2010 and 2015.[133] Although this was double the rate of the early 2000s, it still leaves a major investment gap. Achieving the necessary boost to infrastructure spending will not be easy and will require governments to solve two sets of challenges—how to finance and fund the additional infrastructure, and then how to develop it.

- **Financing and funding infrastructure projects.** Despite current fiscal constraints in many African countries, access to financing is not the major obstacle to increased investment in infrastructure. Rather, the main challenge is a shortage of bankable projects with sufficiently robust and detailed business cases and risk mitigation.[134] This is compounded by high levels of perceived risk by would-be investors. Interviews with investors in the infrastructure sector indicate that developing bankable projects is a particular difficulty in Africa compared with other regions. This leads to delays in

[133] McKinsey Infrastructure Spend and Stock Database. Kenya has been the strongest investor in this group, with investment reaching an estimated 3.7 percent of GDP in 2015.
[134] One key public-private initiative already under way to address the shortage of bankable projects is Africa50, a special delivery vehicle recently launched by the African Development Bank to focus on high-impact national and regional infrastructure projects in the energy, transportation, ICT, and water sectors.

execution and investor perceptions that African projects entail risks that are higher than average—in turn raising the cost of capital. Development banks and public-sector investors from other countries also report that they often struggle to disburse funds in Africa, typically because projects do not meet their strict investment-risk criteria. To unlock greater financing, African governments and infrastructure agencies should therefore focus on developing robust business cases during the pre-feasibility and feasibility phases of major projects. These business cases would include well-tested projections of future demand—often an area in which assumptions are sketchy or overly optimistic. To develop a portfolio of bankable projects, governments need to address gaps in public-sector capacity and capabilities, streamline bureaucratic processes that can delay approvals, and push for greater standardization of contracts and timetables across Africa to simplify negotiations. A specialized agency or task team can help to identify and address barriers, and lead interactions with investors and other stakeholders. Such an agency can also help select the most impactful, effective investment portfolio based on clearly defined impact metrics. Development agencies could help by creating infrastructure funds that include projects that have already been vetted to ease the path to investment by others. They could also structure more deals that combine private investment with donor-provided risk capital and political risk insurance to reduce risk exposure, and thereby encourage more private funders.[135]

1.3%
of GDP spent on infrastructure by Cameroon, Kenya, Nigeria, Senegal, and Zimbabwe, 2010–15

- **Developing new infrastructure.** Even when projects attract sufficient funding and financing, delivering the infrastructure is a challenge in many cases. In most African countries, there is a shortage of skilled engineers, commercial experts, and project managers to engineer, procure, and construct major infrastructure projects. This can lead to cost and schedule escalations. Africa's governments have an opportunity to streamline the delivery of projects by adopting more effective management approaches in the engineering, procurement, and pre-construction phases. They can also ensure the broad application of good project management practices, such as defining clear project roles and responsibilities, using a "stage gate" project management approach, and maintaining a clear, real-time understanding of project progress and performance. In the course of nearly 40 capital productivity studies undertaken over the past two decades, MGI has found that these disciplines can reduce typical delivery costs of infrastructure projects by up to 29 percent. Consistent application of best-practice project management approach helps the infrastructure asset owner avoid many of the frequent causes of excessive spending, including overdesign or "gold plating," late design or scope changes, inefficient procurement practices, and poorly planned and executed construction site activities.

One option for addressing both types of challenge is public-private partnerships (PPPs). These can improve delivery by bringing private-sector skills to planning, design, and construction management, as well as attracting private-sector financing. Although PPPs are not suitable for all projects, they can work effectively where there is a well-defined customer and business case, as is often the case with power projects or business parks. One example is South Africa's Renewable Energy Independent Power Producer Procurement Programme, which has "crowded in" $14 billion in private-sector investment from more than 100 investors, along with deep expertise, with a commitment to generate 4,000 megawatts of renewable power.[136]

[135] Paul Collier and James Cust, "Investing in Africa's infrastructure: Financing and policy options," *Annual Review of Resource Economics*, volume 7, October 2015.

[136] Anton Eberhard, Joel Kolker, and James Leigland, *South Africa's renewable energy IPP procurement program: Success factors and lessons*, World Bank Public-Private Infrastructure Advisory Facility, May 2014.

Today, however, PPPs are underutilized in the region. They accounted for only 4.5 percent of Africa's infrastructure projects by value between 2000 and 2014, compared with 8.6 percent in a group of emerging countries, 2.6 percent in North America, and 5.5 percent in Western Europe.[137] This suggests that Africa could double its use of PPPs to match the level in other major emerging markets. However, to achieve this escalation, governments would need to help reduce their relatively high failure rate in Africa due to insufficient funding or vetting of deals, gaps in the allocation of risks and responsibilities, delays due to complex decision making, and policy uncertainty.[138]

Governments could take additional steps to enable broader use of PPPs. They can help develop in-country specialists with process and project expertise, or encourage financiers and private partners to bring this expertise. They can also adopt an end-to-end deal-making process that includes a clear vision for the role of PPPs, effective governance and institutional frameworks, and a focus on executional excellence, including robust business plans, a transparent tender process, a predefined negotiation schedule, and effective control and feedback processes.

IMPERATIVE 4: DEEPEN REGIONAL INTEGRATION

One of the major thrusts of government effort has to be continuing to deepen regional integration. This will improve Africa's attractiveness to investors and help African-owned companies build scale. Driving closer regional integration is also important for unleashing faster industrialization. In Chapter 3, we noted our finding that three-quarters of the growth potential in Africa's manufacturing output lay in meeting demand within the continent.

Fostering closer regional integration is one of the key ways that African governments can help encourage African-owned companies to build scale, and especially to enable them to tap the potential of manufacturing.

African governments can act on three fronts to strengthen regional integration: (1) help corporate Africa to build scale by reducing the time it takes for goods to cross borders, continuing to lower tariffs between countries, and implementing double taxation agreements; (2) drive closer integration of regional capital markets to help attract FDI; and (3) simplify the movement of business people between African countries.

[137] These figures are the ratio between PPP deals concluded during this period divided by total infrastructure spent by each group of countries, for transportation, water and telecommunications infrastructure projects only. The emerging countries include Brazil, India, Indonesia, Mexico, and Russia, where PPPs accounted for a range of 3 percent to 28 percent of infrastructure spend. Sources include World Bank, Infrastructure Global, Infrastructure Deals, Global Insight, International Transport Forum, and Global Water Intelligence, accessed July 2016.

[138] *Infrastructure financing trends in Africa—2014*, Infrastructure Consortium for Africa, 2014, and the same for 2013 and 2012.

Help corporate Africa to build scale by taking steps to enable intraregional trade

Fostering closer regional integration is one of the key ways that African governments can help encourage African-owned companies to build scale, and especially to enable them to tap the potential of manufacturing. Most African economies are, on their own, small markets—yet we know that investors are attracted by scale, and more likely to invest in a relatively integrated regional market—like those of China, Brazil, and the United States. However, today Africa is a patchwork of more than 50 mostly small economies with only a limited degree of economic integration and political collaboration. There are eight different and partly overlapping regional trade zones, none of which includes more than half of Africa's countries. The best-performing blocs, the East African Community (EAC) and the Southern African Development Community (SADC), export 16 percent and 13 percent of total exports, respectively, to other countries within their regional trade bloc. By comparison, 20 percent of the ASEAN countries' exports are to trading partners within their group, while the figure for the North American Free Trade Agreement (NAFTA) is 33 percent. As a result, African economies rate poorly in connectedness. Only Egypt, Morocco, Nigeria, and South Africa rank in the top 100 connected countries globally, according to the MGI Global Connectedness Index.[139]

This fragmentation helps to explain why even large African companies lack bigger scale, and why so many companies have focused their expansion on their immediate regions. It also hinders the development of African manufacturing. Few manufacturing and services hubs exist as production is highly dispersed across the continent, hindering the formation of new businesses, limiting companies' ability to specialize, and reducing their international competitiveness. The weaker supply base requires many companies to do everything in-house or to import inputs, adding to cost.

The success of some African businesses—and foreign multinationals—in building a pan-African presence together with steadily improving transportation links and communications demonstrates that it is possible for companies to look beyond their home regions and help lead, rather than follow, the ongoing process of Africa's economic integration. As the continent's most successful trade blocs have demonstrated, actions such as reducing border delays, building roads between cities, homogenizing customs processes, and lowering or removing tariffs can quickly expand intraregional trade and strengthen member states' economies. Boosting intraregional trade can help to ensure that a greater proportion of local demand is met by African suppliers and to accelerate manufacturing growth in small countries by giving them access to larger markets that have adopted a common set of standards. The successes of the EAC and SADC provide useful lessons for others (see Box 8, "Unlocking intraregional trade").[140]

[139] *Global flows in a digital age: How trade, finance, people, and data connect the world economy*, McKinsey Global Institute, April 2014.

[140] EAC member states are Burundi, Kenya, Rwanda, Tanzania, and Uganda; South Sudan joined in 2016 but is not included in the figures cited here. SADC's member states are Angola, Botswana, Democratic Republic of Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, United Republic of Tanzania, Zambia, and Zimbabwe.

Drive closer integration of regional capital markets to help attract FDI

Strengthened capital markets will be an important step in attracting equity and debt investment—and the more integrated they are, the better, given the preference among international investors for larger markets. Today, however, most capital markets in Africa are too small to act as a catalyst for regional integration and investment. The exception is the Johannesburg Stock Exchange in South Africa, which had a stock market capitalization of $890 billion in 2015, and trades hundreds of millions of dollars each day.[141] Nigeria, Egypt, and Morocco have effective exchanges with a market capitalization of close to $50 billion each; most other markets are smaller than $10 billion.[142] Africa's markets could also do better to attract international equity, with foreign contributions to equity varying widely, from 12 percent (Morocco) to 19 percent (Johannesburg Stock Exchange) to 58 percent (Nigerian Stock Exchange).[143] Greater regional integration will enable these markets to reach a more effective scale and will create opportunities for partnerships or even mergers between existing exchanges (for example, the Bourse Régionale des Valeurs Mobilières in Abidjan, Côte d'Ivoire, serves eight West African countries). Moreover, stronger capital markets will help to increase the penetration of pension funds and life insurance funds that we have discussed.

55%
of African countries require African visitors to have visas

To strengthen financial integration and therefore help to encourage deeper regional market integration, governments and financial institutions can take specific steps together, including aligning financial, investment, and tax regulations (for example, through treaties to avoid double taxation); developing frameworks to encourage increased cross-border capital flows and investment; building capacity to increase the number of skilled local capital market participants; standardizing systems to the best international levels; encouraging market cross-listings and developing regionally focused investment products; and creating a regional strategy to ensure that bond ratings are comparable.

[141] In 2015, South Africa's stock market was equivalent to 285 percent of GDP, among the world's highest. In the United States, the stock market was 145 percent of GDP, France was 84 percent, and Mexico was 29 percent, according to IMD World Competitiveness Online 1995–2016. Capital IQ, June 29, 2016.

[142] MGI Financial Assets database, July 1, 2016.

[143] 2014 data from the African Securities Exchanges Association.

Box 8. Unlocking intraregional trade

Trade of food, beverages, and other regional processing goods among the 15 member states of SADC, which reached $8 billion in 2014, has grown at 16 percent a year since 2009—significantly faster than the growth of trade within Africa as a whole. SADC's achievements include a one-stop border-post initiative that has significantly reduced border delays. The bloc has also implemented a regional electronic settlement system, which allows businesses in the member states to settle regional transactions through their banks within 24 hours.

In the six-member EAC, intra-bloc trade has also grown rapidly, from around $1 billion in 2005 to nearly $2.5 billion in 2015. While its trade in regional processing goods is still relatively small (at $645 million in 2014), it has grown at 15 percent a year over the past decade. The EAC agreed to a customs union in 2005 and a common market in 2010. As a result, recent research suggests that bilateral trade among its member states is more than double what it would otherwise have been—and that peace and stability have improved in the region.[1]

[1] Thierry Mayer and Mathias Thoenig, *Regional trade agreements and the pacification of Eastern Africa*, International Growth Centre working paper, April 2016.

Simplify the movement of business people between African countries

Another priority that will also help to deepen the integration of regional markets is facilitating business travel in the region for suppliers, customers, and investors. Africans need visas to travel to 55 percent of countries within the continent, and it is easier today for North Americans to travel within Africa than it is for Africans themselves.[144] One useful measure that could help to boost regional trade significantly would be issuing e-visas or allowing visa-free or visa-on-arrival access. The recently launched African Union passport is a step in the right direction.

IMPERATIVE 5: CREATE TOMORROW'S TALENT

Skills shortages are another key constraint on businesses in Africa. In several global surveys, Africa-based companies have reported major challenges in attracting and retaining the talent they need to run and grow their businesses. For example, 31 percent of companies surveyed in South Africa in 2015 said they had difficulties filling jobs.[145] Africa's continued underperformance in education is a major factor behind such shortages. On average, Africans have three years' less schooling than their peers in other emerging regions, and Africa's rate of tertiary education enrollment is half of India's. Compounding this situation is a brain drain: by one measure, more than 10 percent of Africa's university-educated professionals live and work on other continents.[146] Governments have a key role to play in improving schooling and post-secondary education and in ensuring that educational and training systems build the skills needed to support growth. The private sector also needs to act and can build on the skills development programs that several of the best-established and most successful companies in Africa have put in place.

Building vocational skills for tens of millions of young Africans

Data from Egypt, Morocco, and South Africa indicate that by 2021, between 41 percent and 50 percent of jobs will fall into a category we characterize as "skilled entry-level," which includes administrators, craftspeople, and operators.[147] These roles require practical, on-the-job training combined with theoretical training. To develop this talent pool, African countries need to put much greater focus on vocational training—both at the secondary school level and for school-leavers.

Currently, only 8 percent of African students in secondary education are enrolled in vocational programs, compared with 18 percent in East Asia and the Pacific and 17 percent in OECD countries (Exhibit 59). Within Africa, however, these shares vary significantly. Egypt has the highest vocational enrollment at 22 percent, and Ethiopia the lowest at 4 percent.[148] If we assume that the job needs of Egypt, Morocco, and South Africa apply in the rest of Africa, the continent would need to enroll approximately 33 million secondary school students in vocational programs by 2025, up from four million in 2012. To achieve this, governments could embed one- or two-year vocational training programs in school curricula, based on an assessment of a country's future demand for skills; much of the practical training could take place within firms.

An equally aggressive push is needed to expand vocational training for school-leavers, at speed and scale. Options could include short programs, designed in partnership with the private sector, which would teach a few core skills for high-demand sectors such as manufacturing and retail sales. The training would include apprenticeships interspersed with short classroom programs. To deliver such solutions, countries can use private,

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144 *Africa visa openness report 2016*, African Development Bank, February 2016.

145 *Talent shortage survey*, ManpowerGroup, May 2015.

146 The OECD measures this phenomenon by country. In Africa there are a large number of countries where more than 20 percent of the university graduates live in an OECD country, and few with less than 5 percent.

147 Oxford Economics.

148 World Bank education indicators.

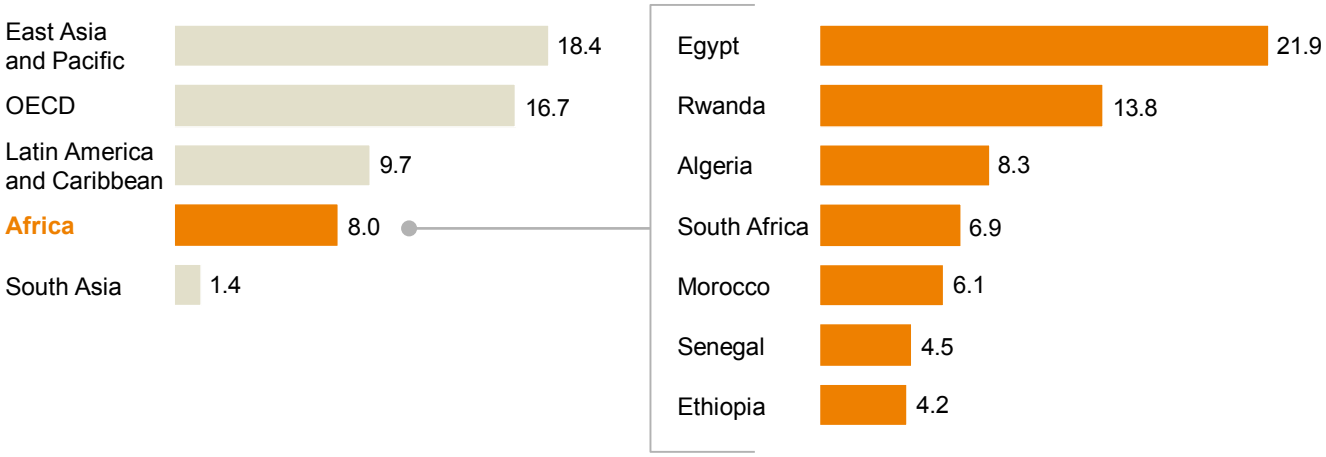
company-funded training institutes, as Morocco has done in partnership with Renault. They can also encourage the development of training programs by private foundations or nongovernmental organizations to help middle school and high school graduates find jobs. One example of this approach is the Generation program in Kenya supported by the McKinsey Social Initiative. The program brings together a range of business and nonprofit partners to train unemployed or underemployed young people for jobs in fast-growing financial services and stock assistant roles in the booming retail sector. Through intensive training programs lasting as little as eight weeks, Generation builds both job-specific technical skills and key personal skills such as teamwork, communication, and resilience. To date, Generation reports that 98 percent of its 1,100 Kenyan graduates have found full-time employment.

Efforts to strengthen vocational training need to be tied to improved matching in the labor market—identifying job seekers with particular skill sets and jobs that require filling with those skill sets. Improved matching can be achieved through increased use of data, better marketing of vocational career paths, and use of online talent platforms to connect people to jobs.[149] In addition, governments—along with their partners in the private sector and across society—need to market the employability benefits and career prospects of vocational training to young people (and their families) given recent evidence that this path is not particularly popular.

Exhibit 59

The penetration of vocational training is significantly lower in Africa than in other emerging markets

Share of students in secondary education enrolled in vocational programs[1]
%



1 2013 or most recent year.

SOURCE: World Bank education indicators; McKinsey Global Institute analysis

Identifying innovative ways to expand access to university education

Of the 49 million African students who finished secondary school in 2012, only six million, or 12 percent, were able to enroll in universities. In the United States, by contrast, the tertiary education enrollment ratio was 89 percent; in Turkey the rate was 79 percent, in China 30 percent, and in India 25 percent.[150] This gap means that Africa is not producing qualified

[149] MGI research has found that these platforms reduce inefficiency and remove barriers in labor market searching and job matching. See *A labor market that works: Connecting talent and opportunity in the digital age*, McKinsey Global Institute, June 2015.

[150] Of a total 187 million young people, 100 million finished a basic education, 49 million finished secondary education, and 38 million had limited or no education, according to the Africa-America Institute.

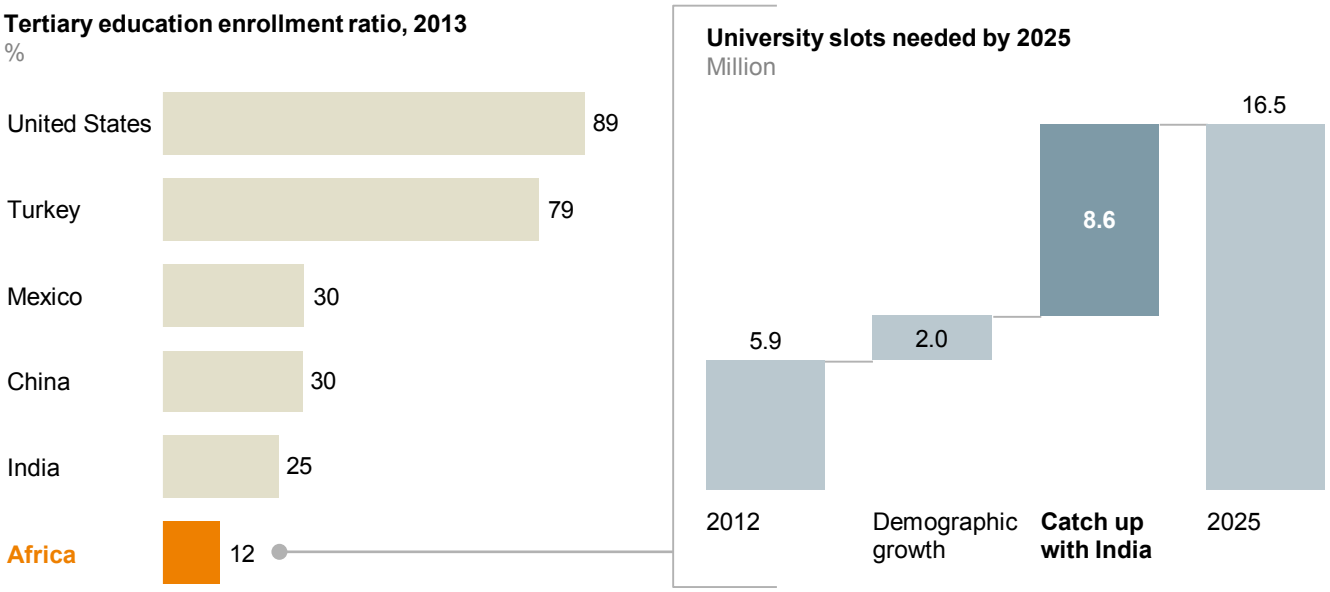
professionals—from engineers and IT specialists to business managers and government administrators—in the numbers needed to underpin accelerated growth.

16M
African university slots needed by 2025 to match Indian enrollment

If Africa as a whole were to match India's enrollment levels, it would need 16 million university slots by 2025. MGI estimates that African countries would need to build approximately 50 large universities (each accommodating about 20,000 students) every year for the next decade to achieve that (Exhibit 60). That level of expansion would require significant additional funding, training of teaching staff, and accommodation—as well as much greater innovation in how university education is delivered at scale. The African Leadership University (ALU), launched in Mauritius in April 2015, is a tangible example of such innovation: it uses technology to reduce teaching costs and deliver best-in-class e-learning, matched with peer-to-peer interaction. The ALU's intention is to build 25 campuses across Africa, each of which will accommodate around 10,000 students.[151] More such universities are needed.

Exhibit 60

Africa's tertiary educational enrollment is low by international standards; to catch up with India would require 16 million university places by 2025



NOTE: Numbers may not sum due to rounding.

SOURCE: World Bank education indicators; McKinsey Global Institute analysis

In parallel, attention needs to be given to improving the quality of existing universities across the continent so that they provide the skills needed for students to more readily enter the workforce; currently, Africa's better universities are concentrated in Ghana, Egypt, Kenya, South Africa, and Uganda.[152] There is also scope to increase the scale and quality of the continuing education programs offered by African universities. In particular, high-quality executive education programs will be needed to build the leadership and management skills to drive growth and productivity in Africa's business sector and to strengthen the capabilities of its senior civil servants. In addition, there is much opportunity for private companies to innovate and expand their internal talent development efforts.

[151] African Leadership University.
[152] *Best 15 African universities in 2016*, Sci Dev.Net, 2016.

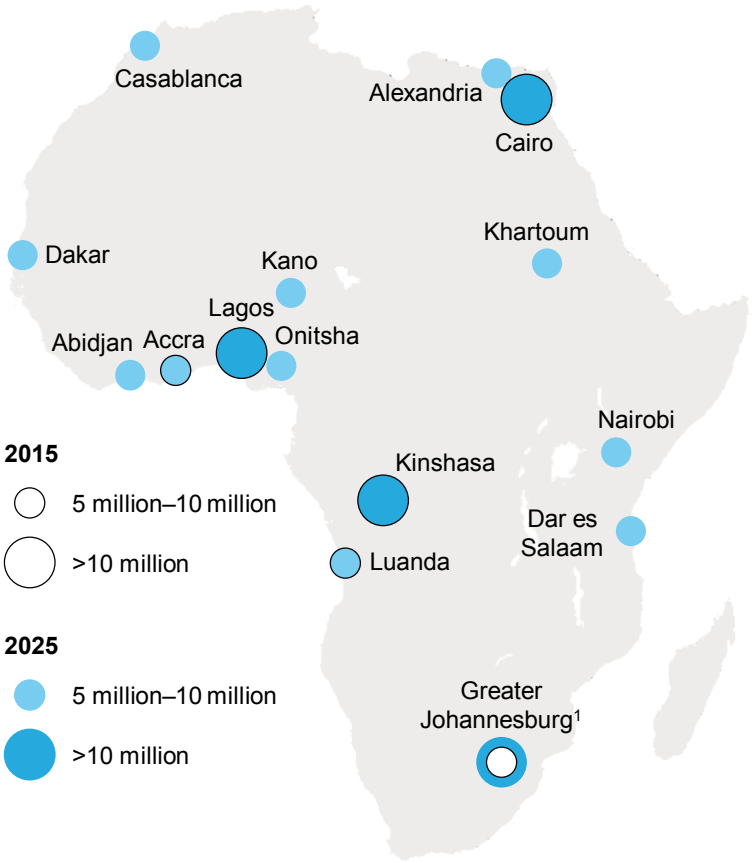
IMPERATIVE 6: ENSURE HEALTHY URBANIZATION

Africa will soon have the world's fastest urbanization rate—and it has very significant potential benefits ahead of it as its cities expand. By 2025, Africa will have more than 100 cities with at least a million inhabitants, including 15 large cities with at least five million inhabitants each (Exhibit 61). Africa's policy makers and urban managers need to prepare for this expansion, investing ahead of the curve to ensure that infrastructure and services meet rising demand, and planning in a concerted way to avoid the pitfalls of unmanaged urbanization and ensure that urban growth translates into sustainable economic development. We suggest that policy makers focus on five dimensions, which we now discuss briefly in turn.

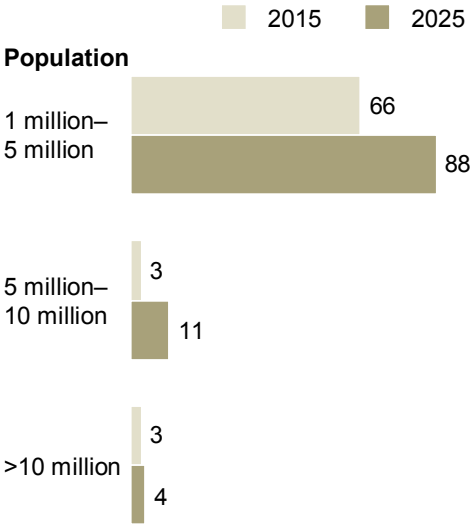
Exhibit 61

By 2025, Africa will have 15 large cities with more than five million inhabitants each, as around 190 million more people live in urban areas

African cities with more than 5 million people each

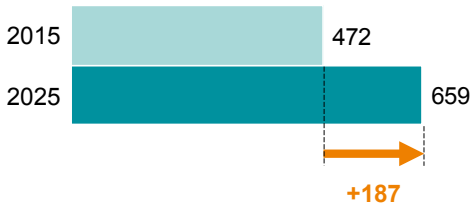


Number of African cities



African urban population

Million



1 Greater Johannesburg includes the City of Johannesburg, Ekurhuleni, and the West Rand.

SOURCE: United Nations World Population Prospect, June 2014 revision, UN population division; MGI Cityscope; McKinsey Global Institute analysis

1. Improve planning capabilities and streamline land registration

Many African cities have room to improve their planning capabilities and streamline urban land registration processes. The continent's bigger cities will need to increase the capacity of their planning authorities. Land rights and registration are a particular challenge on the continent, with sub-Saharan Africa, in particular, scoring poorly on global rankings (Exhibit 62).[153] As a result, many areas lack clarity on land ownership; by some measures, 80 percent of African court cases are triggered by disputes over land ownership. There is

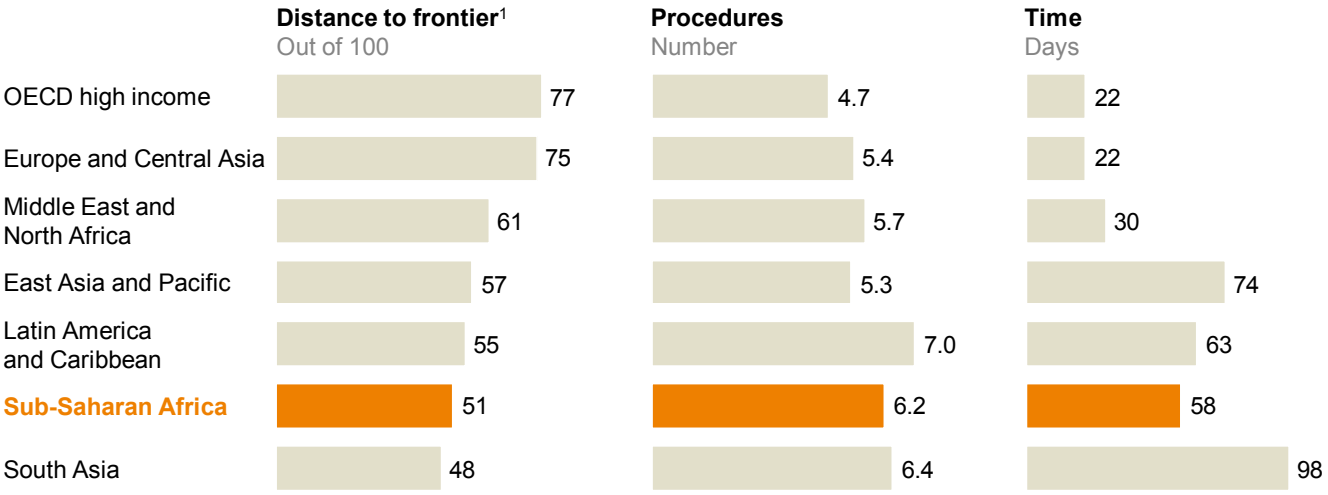
[153] *Doing business 2016: Measuring regulatory quality and efficiency*, World Bank, October 2015.

also a serious disincentive to invest in property. This erodes the urban tax base, impedes urban development projects—including the construction of much-needed affordable housing—and encourages corrupt practices.

Exhibit 62

Africa has particular challenges in land rights and registration

Ease of real estate registration, 2015
Ranking



1 The number 100 equals the highest ease of doing business.

SOURCE: *Doing business 2016*, World Bank, 2016; McKinsey Global Institute analysis

2. Build affordable housing at scale

A major task for city governments will be to deliver affordable housing. Previous MGI research showed that Africa's three largest economies have a significant housing gap. By 2025, 23 million new housing units will be needed, mostly in cities, for households in Egypt, Nigeria, and South Africa.[154] Using current construction methods, the estimated cost of delivering this housing would be nearly $350 billion—but innovative approaches could reduce this by 20 to 50 percent and cut construction time in half. Particular steps that cities can take include unlocking land supply, using private partnerships and an industrial construction approach in housing development, achieving scale and efficiency in operations and maintenance, and reducing financing costs. Cities can also encourage the development of a private-sector ecosystem to improve construction productivity.

Governments can help to accelerate an industrial approach to construction. Steps they can take include expanding public procurement efforts and putting in place uniform building codes and design standardization guidelines, which, in turn, could encourage innovation in construction and building. They can also reduce financing risk by lowering costs or increasing access to financing pools, which would encourage construction companies to invest in industrial-scale construction methods. Finally, as many countries have fragmented construction and real estate industries, governments can encourage participation of smaller players in tenders for public projects to enable them to build their skills base.

[154] *A blueprint for addressing the global affordable housing challenge*, McKinsey Global Institute, October 2014.

3. Design and deliver efficient mass transit systems

Two of Africa's largest cities—Johannesburg and Nairobi—are included in a global index of the top ten most painful cities for commuters.[155] In South Africa, the average daily public transportation commute is two hours, compared with fewer than 75 minutes in more populous countries, including Japan and the United Kingdom.[156] As Africa's rapid urbanization continues, cities must take action to reduce daily commutes and increase business connectivity. Investing in better public transportation, alongside strategies to densify urban development, could therefore give back about 45 minutes every workday to Africa's urban commuters.[157] The experience of cities in other regions is instructive. For example, Hong Kong developed new housing neighborhoods along passenger railway lines between 1970 and 2010, adding 1.4 million households to the metropolitan area. As a result, 43 percent of residents and 56 percent of jobs in Hong Kong are located within 500 meters of rail and metro stations, and 90 percent of all journeys take place on public transportation.[158]

2 HOURS
average daily commute in South Africa vs. <75 minutes in Japan or the United Kingdom

4. Increase access to electricity

In 2013, only 68 percent of Africa's urban residents had access to electricity, and in many countries the figure is much lower.[159] Cities can take bold steps to accelerate electrification and achieve universal access by 2025. Kenya provides an example of the rapid progress that is possible: it increased its urban population's access to electricity from 50 percent in 2010 to 60 percent in 2013. To achieve this, Kenya's government designed its electrification program to drive the scale needed to encourage cost reduction, focused intensively on delivery, and developed a financing model that set clear elements that the private sector could deliver on. Other countries can emulate this approach. They will need to ensure that national utilities are realistic about how much infrastructure they can deliver, and they will need to create scope for the private sector to bid to deliver the rest. They will also need to nurture a strong supply chain, often from scratch, spanning everything from wires and poles to meters and substations. Alongside the distribution system, they will need to ramp up generation capacity in a cost-effective way, which, again, could involve competitive private-sector bidding. To create robust business cases for investment in electrification, countries and cities will need solutions to simplify and enforce the collection of bills (one solution is cellphone-based smart metering) to ensure that the costs of connecting an entire town or neighborhood (in order to achieve scale) will deliver the revenue needed to justify the investment. They also need to pay attention to reducing transmission losses, which are often a serious source of waste. Together, these steps will enhance revenue and drive down costs, and thereby release funding to help people who cannot afford to pay for electricity. Finally, governments can explore off-grid electrification options to supplement their own efforts, which are increasingly becoming financially viable and technically acceptable. These solutions are typically driven fully by the private sector, and enabled by an appropriate policy environment.

5. Install more ICT infrastructure

Information and communication technology (ICT) and data connectivity remain an area where Africa ranks poorly; for instance, it scores 2.5 in ICT development compared with 4.7 for Asia and a global average of 5.0.[160] According to MGI research, Africa could invest

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155 *The globalization of traffic congestion: IBM 2010 commuter pain survey*, IBM, June 2010.

156 "National household travel survey 2013," Statistics South Africa, July 2014.

157 Densification can be achieved either by reducing floor space per person or by increasing the height of buildings beyond a single story. The former comes at a cost to quality of life, while the latter is more expensive. See Paul Collier, *African urbanization: An analytic policy guide*, International Growth Centre working paper, 2016.

158 For a detailed discussion, see *A blueprint for addressing the global affordable housing challenge*, McKinsey Global Institute, October 2014.

159 Rural areas are even worse off than urban areas in most cases. See *World energy outlook 2015*, International Energy Agency, November 2015.

160 ICT development index 2015, United Nations International Telecommunication Union, 2015.

significantly more in ICT infrastructure. African countries spend less than $10 per capita on ICT, compared with $32 per capita in Brazil and $65 in Taiwan.[161] Given the importance of communications and data connectivity for economic development and service delivery, cities need to plan ahead—for example, by making cable infrastructure compulsory in all new construction projects. To accelerate the rollout of ICT infrastructure, cities typically need to build effective partnerships with the private sector.

TRANSFORMING PUBLIC LEADERSHIP AND GOVERNANCE IS AN OVERARCHING PRIORITY

Delivering on these six priorities will require a step change in the quality of Africa's public leadership and institutions. All these imperatives require the vision and determination to drive far-reaching reforms in many areas of public life—and a capable public administration with the skill and commitment to implement such reforms. With public finances under pressure and new resources needed for urban development, education, and more, governments will need to focus on driving greater productivity—including by better prioritizing investments, cutting wastage, and effectively monitoring the performance of public agencies. They will also need to adopt a strategic approach to workforce planning, ensuring that critical state functions (including tax collection, infrastructure development, and city planning) are staffed with skilled professionals whose development and motivation are supported by effective performance management systems. To accelerate these and other reforms, governments can use digital technologies and approaches to automate processes, increase transparency, and improve interactions with citizens. Last but by no means least, Africa must move to catch up to other regions in the strength of its business climate and its effectiveness in fighting corruption, measures in which it placed last in world rankings.[162]

Transforming public administration and governance does not have to be complex. Successful countries have put in place simple, quick, yet high-impact measures to improve their business environment, deal with small-scale corruption, and improve the measurement and quality of service delivery. Common actions include setting maximum processing times for permits and registrations, increasing the transparency of government fee structures, and risk-based compliance processes that focus effort on more probable contraventions. Rwanda provides a compelling example of what can be achieved. The East African nation set up a task force to improve its business environment in 2007. Reforms included setting up an effective "One Stop Centre" for investors, streamlining construction permitting, introducing a simplified fixed fee for property registration, extending customs hours, and instituting risk-based customs inspections.[163] Its ranking on the ease of doing business climbed from 143rd in the world in 2008 to 32nd in 2014.

•••

Governments have a significant role to play in unlocking their countries' economic growth potential and accelerating growth and development. The reforms required will not be easy, but they are essential if Africa is to strengthen its competitiveness in a challenging global economy. What the past five years have shown is that Africa's diverse economies—its economic lions—now need to improve their fitness in order to make the most of their undoubted long-term growth potential and continue their march toward prosperity.

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[161] *Lions go digital: The internet's transformative potential in Africa*, McKinsey Global Institute, November 2013.

[162] *Doing business 2016: Measuring regulatory quality and efficiency*, World Bank, October 2015; Transparency International.

[163] Risk-based inspections allow for a better allocation of public resources by targeting high-risk segments for inspection. Examples include prioritizing the inspection of buildings in environmentally sensitive areas during construction or auditing segments of the economy more likely to under-report sales in tax audits. *Doing business 2014: What role should risk-based inspections play in construction?* World Bank, October 2013.

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